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In the matter of: :

COMPULSORY LICENSE FOR SECONDARY :

TRANSMISSIONS BY CABLE SYSTEMS; :

ROYALTY ADJUSTMENT PROCEEDING :
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:CRT Docket 80-3

2100 K Street, N.W.
Room 610
Washington, D.C.

Tuesday, September 30, 1980

The hearing in the above-entitled matter commenced
at 10:00 a.m., pursuant to adjournment.

BEFORE:

MARY LOU BURG, Chairman

THOMAS C. BRENNAN, Commissioner

CLARENCE L. JAMES, JR., Commissioner

FRANCES GARCIA, Commissioner

1 APPEARANCES:

2 FRITZ ATTAWAY, Attorney-at-Law
3 Counsel for Copyright Owners

4 STUART F. FELDSTEIN, Attorney-at-Law
5 Counsel for NCTA

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C O N T E N T S

<u>WITNESS:</u>	<u>Direct</u>	<u>Cross</u>	<u>Redirect</u>	<u>Recross</u>
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P R O C E E D I N G S

CHAIRMAN BURG: All right, Mr. Attaway you may continue with your witness, Mr. Korn.

MR. ATTAWAY: Thank you.

Whereupon

ALEXANDER KORN

resumed as the witness and, still under oath, was examined and testified further, as follows:

DIRECT EXAMINATION (continued)

BY MR. ATTAWAY:

Q Mr. Korn, yesterday you spoke about the CPI and recommended use of the CPI as a yardstick to measure inflation in this proceeding. You also talked about the PCE recommended by Mr. Crandall, and you listed the advantages of the CPI over the PCE.

Before we go on to the next topic, would you give us an indication of how the CPI and the PCE have increased since the base period we are concerned with here to the present?

A I just happened to have written them down. The actual don't mean too much because you are converting it all to base October 1976. So, I would not worry too much about what the actual numbers were.

For the record and for your information, the CPI went from 173.3 in October '76 to 242.5 in April 1980 for an increase of 39.93 percent. During the same period the PCE increased 31.75 percent. The latest figure available is July 1980, and

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1 to bring you up to date, I calculated the increase from
2 October '76 to July 1980, which is 42.99 percent for CPI and
3 33.98 percent for the PCE.

4 In order for this not be confusing on what goes on from
5 here on, I want you to know we will use one set of numbers so
6 that you, of course, will be using the latest set depending on
7 what period you are going to be talking about, whether it's
8 going to be the second half of 1980 or the first half of 1981.

9 For the rest of this discussion we won't use the PCE
10 at all and we will use only this set of numbers down to here.
11 (indicating) I did not have anything later at the time I
12 prepared this. So, what we will be talking about is an increase
13 in the CPI of around 40 percent.

14 Q Mr. Korn, before you address yourself to the
15 adjustment necessary to maintain the real constant dollar level
16 of the royalty fee, would you address the adjustment that must
17 be made to the small system dollar sealing in the statute, the
18 \$80,000 and \$160,000 levels that also must be adjusted in the
19 proceeding?

20 A Right. The statute says, "The gross receipts
21 limitation established by Section 111, (d), 2 CI shall be
22 adjusted to reflect national monetary inflation or deflation,
23 or changes in the average rates charged cable systems subscri-
24 bers," and then it goes on. "To maintain the real constant
25 dollar value of the exemption provided by such section.

So, therefore, two things have to be taken into

1 account, the maintenance of the real value of the dollar
2 and the average subscriber rates." It seems to me what act
3 has intended to do was really protect the small cable systems
4 rather than the copyright owner, and to protect them from the
5 fact--from the possibility that they will be thrown into a higher
6 category just because they raise their rates.

7 The simple interpretation that I have of this is that
8 the intent was to raise the \$80,000 and \$160,000 limitations
9 in accordance with the raise in their rates. If a cable system
10 actually raised their rates, say, by 40 percent by October, they
11 should still be in the same category that they were before because
12 they have kept pace with inflation. They have not exceeded it.

13 Likewise, if a cable system raised their rates only
14 ten percent since last October, then their limitation should
15 just be ten percent above the \$160,000 limit.

16 Q Mr. Korn, you're referring to October of '76?

17 A Right. So, my interpretation is that the--since on the
18 average the rates increased 39.93 percent, you take the limits.
19 \$80,000--I'm sorry. On the average the cable rates increased
20 15 percent, which was the figure that you had yesterday pretty
21 consistently from \$6.60 to \$7.50, about 15 percent. Then on
22 the average you would simply apply that to the \$80,000 limit
23 and \$160,000 limit.

24 The \$80,000 would then become 92,120, and the \$160,000
25 would become 184,240. Now, you might say where does the
inflation come in? Well, it seems to me that the inflation.

1 factor would be that if they raise their rates higher than
2 inflation, in other words, if a system went higher than
3 inflation, that should throw him into a higher bracket because
4 he went up faster than inflation. And therefore, inflation is
5 the top level. If the average exceeded inflation, then inflation
6 would have been--the 1.40 would have been the proper level
7 rather than the 1.15, which is the level that the rates actually
8 went up. Now, of course, that's treating it on an industry
9 wide basis. You do have a problem because some cable systems
10 have raised their rates faster than others.

11 But on an industry wide basis, that's the way I would
12 recommend that you handle it. In other words, the average
13 increase in cable rates was 15 percent since October '76.
14 Therefore, the gross revenue limitations will be, likewise,
15 raised 15 percent for the current period.

16 If you do it semiannually, you have to find an average
17 increase in rates and publish the new gross limitations. In each
18 case, it would go up with the average increase in rates.

19 Q Mr. Korn, are you recommending an industry wide
20 adjustment or an individual adjustment?

21 A No. I'm explaining both possibilities, but I am
22 recommending a cable system by cable system adjustment, which
23 has many advantages as you will see. You have solved some of
24 the problems we talked about yesterday. You also solved the
25 problem of where do you get the figure on the average cable
rates.

1 Each cable system knows its own rate, but there is no
2 real current figure on average industry cable rates.

3 Q Mr. Korn, in the questionnaire, the cover letter to the
4 questionnaire that the Tribunal sent out earlier this year,
5 the Tribunal said, "The Tribunal is also required to consider
6 adjustment of the special small system of gross receipts limita-
7 tions to insure the systems of the size entitled to the
8 exemptions in 1976 continued to be so entitled."

9 Does your recommendation precisely do what the
10 Tribunal suggested be done in this sense?

11 A I think that's the interpretation that fits that
12 description and also fits the intent of this section of the Act.
13 In other words, in general that a system is not thrown into a
14 higher category simply because it raised its rates, unless it
15 raised it them so fast it exceeded inflation. That's the thing
16 that this whole theory is based on.

17 Q According to your recommendation, the cable system,
18 with the same number of subscribers had in 1976, carrying the
19 same number of distant signal as it did in 1976, would be
20 precisely in the same category it was in 1976 unless it raised
21 its rates higher than the rate of inflation?

22 A Correct.

23 Q Thank you. Now turning to the real constant dollar
24 adjustment of the royalty rates, would you first of all
25 describe the base that the Tribunal should look to in making
this adjustment?

1 A. We are talking about the larger systems now, the
2 Form Three systems. Section 801 describes pretty clearly what
3 is to be adjusted, and it seems to me that it's the fee schedule
4 that you have to adjust. It says that the adjustment is
5 for "the rates established by Section 111, (d) 2 B." And that
6 is the DSE schedule rates.

7 Secondly, the Act permits the Tribunal to consider
8 the two elements we just discussed, the national monetary
9 inflation or deflation. In this context, it simply means a
10 change in the CPI, in other words, the 40 percent increase.
11 The second is the change in the cable rates.

12 Now, assuming the prices in general have increased by
13 40 percent since October '76 to the first half of 1980, and
14 the cable system was paying 1.1 percent of its base revenues
15 for two DSE's as royalty fees, now this same cable system should
16 be paying 40 percent higher rate all for the current period,
17 or 40 percent higher than 1.1 or 1.54 percent.

18 If the rates are charged per subscribers, the basic
19 service did not change, I don't think there is too much question
20 about that. Now, we come to the second element, the average
21 rates charged to cable subscribers for the basic service.

22 Let's get back to our example. Assuming, again, that
23 prices in general increased by 40 percent from October '76 level
24 and the cable system was paying a copyright fee of 1.1 percent.
25 for two DSE's in October of '76, but this cable system had

1 increased its subscriber charge of basic service from \$5 and
2 \$7 in current period, the Tribunal can take this into account
3 by saying that because the system increased the subscriber fee
4 by 40 percent and thus kept pace with inflation this should
5 be no increase in the DSE's percentage. In other words, he
6 would have no adjustment. He has kept pace with inflation. I
7 would concur if you did that.

8 Q Mr. Korn, how should the adjustment that you have
9 recommended be made; should be the same for every cable
10 system, or should it be tailored to each individual cable
11 system?

12 A Before I go into a little detail on that because
13 we are going to be talking about changes in percentages and
14 I'm going to introduce Exhibit 14 which you have in front in you,
15 let me just briefly say that you have to be very careful when
16 you deal with percentages, percentages based on something, based
17 of something, and if you are talking about just percentages you
18 have to know what they're of because you can't just add or
19 subtract them unless they are of the same base, based on the
20 same period.

21 For example, let's say somebody had a \$10 rate in
22 1976 and in 1980, it was \$15. Now the change is \$5. Now, if
23 I asked anybody in this room what percent change was there in
24 the rate from '76 to '80, I'm sure everybody would say plus
25 50 percent, increased it 50 percent.

If I said what is the 1980 figure compared to '76,

1 you would say 150 percent. Now, it is 150 percent. Now,
2 what we don't normally think of, but which is understood when
3 we say that, is that the base is 1976. It is 50 percent of the
4 1976 base, 150 percent of the 1976 base. So really what we
5 have to remember is with respect to 1976 when we talk that
6 way. Now, just converting these into, instead of percentages
7 let's make it decimals, it's easier to figure, and that's what
8 we will be using from now on. 50 percent is .50. So 50 percent
9 of 150 is 1.50. Sometimes it is necessary to look at the change
10 or this figure here, not with respect to the old base, but with
11 respect to the new base. So, if I asked you, now, what is
12 the change with respect to 1980, I am sure everybody would say
13 it's .50 over 1.50, or 33 1/3 percent. Right?

14 In other word, the change, looking at it from 1980
15 figures is 33 1/3 percent. Now, this is with respect to 1980.
16 So, if we have a change on one base and we have the figure which
17 shows what it is at that time, we simply divided the change by
18 that figure to get the change of the new base. In other words,
19 50 is 1/3 of 150. Everybody knows that. So the way you do it
20 is just divide by 150. With that in mind we will hand out
21 Exhibit 14 which will now describe the adjustment in general.

22 (CO's Exhibit No. 14 was marked and received in
23 evidence.)

24 THE WITNESS: Actually, this adjustment will be the
25 same one being made for the overall average or the individual
systems. This explains the adjustment. The first line shows

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1 the average cable rates per subscriber. That was discussed
2 yesterday. The averages I have used are the ones that Alan
3 Cooper summarized from the CRT questionnaire, the \$6.60 in
4 October of '76. The CPI, as we just discussed, went up 39.931
5 percent. I'm now at the point where it says adjustment of DSE s
6 for Form Three systems. We take the CPI increase of .399 and
7 subtract the cable rate increase of .515, the difference to be
8 adjusted for is .2478. In other words, 25 percent. Now, were
9 we to apply that to the 1976 revenues, that would be the proper
10 figure, but we know we are going to apply it to 1980 revenues.

11 We have to convert this difference from October '76 to
12 April '80 base because it will eventually be applied to the
13 1980 revenues. Now we do that the same way we did this. We
14 divide it by the 1.1515, which is the new 1980 figure in terms
15 of the old, to get .2152. So, for Form Three system, you
16 simply add 21 percent to the--that would be your surcharge to
17 the DSE schedules. So instead of .675, it becomes .675 multi-
18 plied by 1.2152 or 82, and the two signals, the same procedure,
19 et cetera.

20 On the same sheet, so that you have it in front of
21 you, I showed again how we would adjust the borderline for
22 the small systems. Take the present \$80,000 and multiply it by
23 the increase in cable rates to get 92,120.

24 Q You have just described what the Tribunal could do if
25 chosen to make an overall industry adjustment to the royalty
rates. However, you said it before, this is not what

1 you're recommending. What are you recommending?

2 A I'm recommending that the same procedure be essentially
3 used on a cable system-by-cable system basis, and that by
4 simple change in your Form Three, which change I will illustrate
5 with the worksheet I have, it will be possible for each
6 system to have it's own adjustment based on its on cable rate
7 increase. The reason for that is that although it doesn't
8 really make to the copyright owner, I would think, whether
9 you do it one way of the other, it does make a difference to
10 the cable system because a cable system that had a very small
11 increase in its own rate would be getting the benefit of the
12 average adjustment, which may be much larger. At the same
13 time, it's base would be small because it did not increase its
14 cable rates.

15 So it would be getting sort of a double benefit of it.
16 On the other hand, they would not care. On the other hand,
17 those cable systems that did increase its rates substantially
18 would be paying, not only the average surcharge, but his base
19 is increased because he has increased his rates, he has paid on
20 a higher base, and therefore, he certainly wouldn't like it.
21 It also solves many problems when you do it on an individual
22 basis. For example, we discussed yesterday systems that have
23 very low rates in basic tier service or charge zero, free basic
24 tier service. And, you will see when we will get into it,
25 those problems are solved and handled on an individual basis.

Also, I think the law itself says that if a cable

1 system increased its rate to an extent higher than inflation
2 you would only go to the inflation point. So, you certainly
3 wouldn't want that. You would have to exempt them. If
4 cable system increased its rates to exceed inflation, that
5 it had no surcharge, it would use the old schedule. And I
6 don't see how you could handle that on an industry basis.
7 The cable system would have to be identified that it did increase
8 its rate.

9 So, those are some of the reasons I believe that it
10 should be done on an individual basis.

11 Q Mr. Cooper spoke about tiering in his testimony. You
12 just mentioned the problems that could be met by a system
13 adjustment. Would you describe the effects of tiering on
14 future royalty payments?

15 A Now, when the Act was passed in 1976, all cable
16 systems had a basic subscriber service consisting of local
17 or distant signals only if you had pay channels as a second
18 tiers of service at that time.

19 Now, the current trend, of course, is to go more
20 into pay and to charge less for the basic service tier. But
21 since we have 1976, October '76 base of, you might say, normal
22 charges, you can use that fact if you work on an individual
23 cable system basis to come out with the proper adjustment, even
24 if the cable system had lowered its rates.

25 If you do it on a cable system basis, then any cable
system that had lowered its rates would have to have a

1 greater offset in its inflation surcharge. It automatically
2 comes out that way as you will see. In other words, this
3 method keeps the value of the royalty fee the same except for
4 the change of inflation, in other words, in constant dollars,
5 exactly what the Act tells you to do, whether the cable
6 system increased its rates, kept them the same or even lowered
7 them.

8 Furthermore, the other problems with the tiering is
9 the fact that some of them may give free service for the
10 basic charge. You can easily have that system come up with a
11 base which you would describe based on the average revenue
12 per subscriber for the industry times the number of subscri-
13 bers he has.

14 For example, for 1980 it would be around--we get to
15 it later--but I think it's around \$7. So, the cable system
16 would simply use as his revenue against which to apply the
17 percentage a constructed revenue which would be \$7 times six
18 months times--and then multiply. That would be the revenue
19 which you would then apply to the royalty percentages.

20 Q So, what you are recommending is a way of meeting
21 the concern of Congress expressed in the House Report that
22 cable systems may reduce their basic charge as an inducement
23 for individuals to become subscribers to additional subscri-
24 bers. What you are doing is, by recommending a system-by-sys-
25 tem adjustment, you are only adjusting the rates for those
systems that have actually changed their subscriber base as

1 Congress thought they might and adjusting their rate precisely
2 to make up for that change.

3 A That's right. The adjustment would be, not only for
4 inflation, but the offset to that inflation adjustment would take
5 into account the cable rates. If they increased, it would
6 be a deduction from inflation. If they decreased, it would
7 be an addition to inflation. And that effect is that the net
8 change always reflects the particular cable system's own change
9 rates even if they go down.

10 Q If royalties are to be adjusted by each individual
11 cable system, based upon its basic rates in 1976, how do make
12 this adjustment for cable systems that are new and didn't
13 exist in 1976 or cable systems that have no 1980 rate to
14 compare with the 1976 rate?

15 A Those that did not exist in '76, they do have a
16 1980 rate, and they also have 1980 revenue figures against
17 which to apply it. The only thing that I'm missing is the
18 1976 rate from which to measure their current rate. I would
19 just assign to them the average industry rate of \$6.60.

20 Q What about systems with no 1980 rate?

21 A Systems with no 1980 rate, because they have a zero
22 rate, I would simply assign to them the same figure for 1980,
23 \$6.50. That sounds strange right off the bat. But when you
24 think about it, the way the systems works out, if you have the
25 same rate in '76 and '80, both, then you would get the full
effect of inflation. So, in effect, the system that has no

1 1980 rate. will get the full effect of inflation if you assign
2 the same \$6.60 for 1980 rate.

3 COMMISSIONER GARCIA: Explain that to me. How does
4 a system not have a 1980 rate?

5 THE WITNESS: They may have free service in 1980 for
6 the basic rate. This may just be theoretical up to date. But
7 for the next five years, as you have seen in these franchise
8 applications, it is very likely to happen.

9 MR. ATTAWAY: Madam Chairman, we discovered an error
10 in the next exhibit we would like to present. May we have a
11 five-minute recess to discuss this with Mr. Korn before we
12 proceed?

13 CHAIRMAN BURG: Of course.

14 (A brief recess was taken.)

15 BY MR. ATTAWAY:

16 Q The statute provides for a rate review proceeding every
17 five years to adjust for inflation in changes into average
18 charges to subscribers. If the adjustment to be made this year
19 does not contain a further periodical adjustment for increases
20 in inflation, what will the effect be on these subscriber
21 payments made between 1980 and 1985 in terms of coming up with
22 real constant dollar value? In other words, will the
23 purpose of the statute to maintain the real constant dollar
24 value of the royalty payment be met if a one shot, one-time
25 adjustment is made in 1980 without any further adjustment
during the intervening years to 1985?

1 A No. As you can see, the one shot adjustment would
2 not have worked during the period October '76 to date because
3 they are 40 percent behind right now. No one knows how fast
4 inflation is going to increase over the next five years, but
5 it is definitely going to go up. The difference, of course, will
6 be if it makes the one shot adjustment, that adjustment will
7 apply for every semiannual reporting period and every semi-
8 annual royalty fee. But if you adjust it every semiannually,
9 it will go up with inflation.

10 I did some rough calculations which I understand
11 have to be revised because we took a yearly figure instead
12 of a semiannually figure. But it would be in the neighborhood
13 of the next five years of 12 percent, a \$12 million difference
14 in royalty fee assuming a fairly conservative investment of
15 about eight percent inflation rate.

16 CHAIRMAN BURG: So you are saying adjust this as you
17 go.

18 THE WITNESS: The same way you do the music fees--

19 CHAIRMAN BURG: Doesn't that, in effect obviate the
20 need for a five-year review?

21 THE WITNESS: I would assume in a five-year review
22 you would get into basic questions like today. Are we doing
23 it right? What are the things that have happened in the
24 industry. It might work out that you might not need a five-
25 year review. It may work out splendidly, I don't know. But
certainly it won't work out with a one shot adjustment for

1 inflation. Just as you have done the non-commercial
2 royalty fee annually, because they file annually, I would
3 recommend that you do the same thing here. When the fee is filed
4 semiannually, the adjustment should be made automatically, by
5 your publishing the 1.40 or whatever the latest figure is that
6 you are using for the CPI. I will show you how each cable
7 system can make its own adjustment when it files its fees.

8 BY MR. ATTAWAY:

9 Q Mr. Korn, you estimated the shortfall from 1980 to
10 1985 would be in the neighborhood of \$12 million. Are you
11 prepared to demonstrate how you arrived at this figure in a
12 submission to the Tribunal tomorrow once you have had an
13 opportunity to revise the chart we found an error in?

14 A Yes. We will revise the exhibit and submit it for
15 the record. I'm not sure it will come out exactly \$12 million
16 because that is a rough estimate based on the fact that we use
17 a yearly figure instead of a half-year figure.

18 Q Mr. Korn, would you explain, demonstrate to the
19 Tribunal, how each cable system can make its own adjustment to
20 maintain the real constant dollar value of its royalty
21 payment when it files semiannual payment of the account?

22 A To do that, I would like to hand out some blank
worksheets which we can follow line by line.

23 MR. ATTAWAY: This is not an exhibit. It will be
24 included in one of our subsequent exhibits. This is to
25 help you follow his testimony.

1 THE WITNESS: I will give you the figures as we go
2 along. I will also do the multiplications for you. The
3 first line is the figure you will publish the same way you do
4 on the non-commercial TV stations. The second line says,
5 "October 1976 subscriber rate." Let's put in a figure of
6 \$6 there. The third line is the April 1981 subscriber rate.
7 We are assuming here that this is for the first half of 1981
8 that we are filing for. I recommend you use the April figures
9 both for the index and for the subscriber rate.

10 Let's say this system didn't change at all. It had
11 \$6 also. So, line three is \$6. Line four says divide line
12 three by line two. I won't do that for you. You can do that
13 yourself. Six divided by six is one. Subtract line four
14 from line one. That's .500. Line six says if line is
15 zero or negative--well, that doesn't apply here. So forget
16 that. Line seven says divide line five by line four. Well,
17 line five is .500, and line four is one. So forget .500.

18 Now, this is the constant dollar surcharge rate
19 for this particular system. You can see it is probably right
20 because the system did not change its rate. Therefore, you
21 get the full effect of inflation which, in this case, is 50
22 percent as you can see from the first line.

23 Now, let's work it out--no, let's not. Let's go to
24 another page and take another example. I will give you the
25 bottom filled out. You won't have to fill it out later. Let's
go to another page and take another example. I will give you

1 a hard one this time.

2 COMMISSIONER GARCIA: On the one we just did, where
3 we were using \$6, should we have used \$6.60?

4 THE WITNESS: No, this is the actual rate. Each one will
5 put his own rate in. I'm saying this particular cable system
6 had a \$6 rate which it didn't change over the period. This is
7 not industry average anymore. We are talking about a system-by
8 system--this would be part of your Form Three in other words.
9 On the second sheet, again, we are starting with a 1.50 inflation
10 rate. And this system had a \$6 rate in 1976.

11 So, line two is \$6. Line three, April 1981, the rate
12 was \$8. In other words, it had increased its rate from \$6
13 to \$8. Line four says divide line three by line two to three
14 decimal places. I will do that for you. It's 1.333. Line
15 five subtracts line four from line one. You can do that
16 yourself, but I will tell you the answers. It's 1.167.
17 Line six says if line five is zero or negative do something.
18 But it's not zero or negative. So just forget that. Line
19 seven says divide five by line four. I will do that division
20 for you. It's 1.67 over 1.333, and the answer is 0.125.

21 Now, that's the constant dollar surcharge rate for
22 this particular system. In other words, if he had three DSE's
23 and the old rate was 0.1525, the new rate would be 12 1/2
24 percent higher, whatever that comes out to. I will give
25 you the actual figures in the exhibit.

25 The second half of this worksheet will actually

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1.125

1 demonstrate, when we get to the four different examples, that the
2 royalty is constant dollars; in other words, it will only change
3 by inflation, is kept constant if we take a system that has
4 the same number of subscribers in other periods and the same
5 number of DSE's.

6 I will now hand out Exhibit 16, which is the same
7 worksheet, but they will be filled out and there will be
8 a cover sheet on it which will give you the assumptions made in
9 the illustration. This will demonstrate that the royalty
10 fee per subscriber will remain the same.

11 (CO's Exhibit No. 16 was marked and received
12 in evidence.)

13 THE WITNESS: Looking at the cover sheet only for
14 a minute, the cable systems we are talking about in this
15 illustration, the cable systems filing statement of account
16 for the first accounting period in 1981, and it has 5,000
17 subscribers. It has a 1976 subscriber rate of \$6 in each
18 case. In other words, they all start out with the same
19 subscriber rate. It has the same number of DSE's in both
20 periods. As before, the constant dollar index determined
21 by CRT, is 1.50, which is simply the CPI.

22 There is one more thing I want to say before we go
23 into the example. The revenue in each case is intentionally
24 set equal to the monthly subscriber rate times six months, times
25 the 5,000 subscribers. In other words, in order to demonstrate
the point, I have set the revenue in each case to be equal

1 to the subscriber rate times six months, times the number.
2 of subscribers. So that if the real constant dollar value is
3 maintained, we should get a figure here which is constant no
4 matter whether the rates went up or down or stayed the same
5 or whatever. We can almost guess at what the figure would be.
6 In 1976, we know that the revenue is \$6 times six months,
7 times \$5,000 or \$180,000.

8 Now, \$180,000 revenue with a three DSE percentage applied,
9 that percentage being .01525, gives you \$2745 fee. If there
10 was one in 1976, you would have paid that. I'm going to
11 guess at the answer and show you how to determine the answer
12 before you start. So, this is very helpful. In other words,
13 the 1976 fee would have been 2745 based on these figures.

14 Now, if inflation went up 50 percent, you would simply
15 multiply that by 1.5, and you would guess, before you even
16 start, that the constant dollar fee you are going to get
17 in 1981 is 4117, 1.5 times \$2745.

18 Now on the first page, my first example shows line two with
19 a \$6 rate and line three with a \$5 rate. In other words, here
20 is an example where in October '76 the cable company charged
21 \$6 but it lowered its rate for its basic service. Line three
22 divided by line two is 8.33. Line five, therefore, becomes
23 667, that's .667. Line seven divided by line four is .80.
24 So that the surcharge for this cable company is 80 percent.
25 You notice that it's higher than inflation. Inflation is 50
percent. The reason for that is that he dropped his rates.

1 So, that is how it makes up for the drop in rate. Now, his
2 gross revenue for the six-month period was \$150,000. In
3 order to see whether he's in the small system category, he has
4 to find out what his borderline is. Line (b) says multiply
5 line four, above, by \$160,000. Line four, above, is simply
6 his increase or decrease in rates. Therefore, his \$160,000
7 went down to \$133,000 because lowered his rates, keeping
8 him in line with his own rates. He is not going into a dif-
9 ferent class because he changed his rates. Line (c) gives
10 the royalty percentage for three DSE's, which is .10525.
11 Line (d) is simply the same surcharge you found above, .80.
12 And line (e) you multiply .80 by the royalty percentage to
13 get the additional percentage which is .0122, and line (f)
14 you add that to the royalty percentage to come out with an
15 adjusted royalty rate of .02745, instead of the original
16 one which is .01525.

17 When you multiply the adjusted royalty rate by the
18 gross revenue, the result is in line (g), \$4,117. So, this
19 particular system would have to pay \$4,117. Now, this is
20 the toughest one. The others are easy.

21 MR. ATTAWAY: Before you go to the next table, let's
22 spend a little bit more time on the adjustment of the small
23 system ceiling, the system paid under the DSE schedule, or
24 would have paid under the DSE schedule of 1976, right?

25 THE WITNESS: Right.

BY MR. ATTAWAY:

1 Q If there were not a downward adjustment of the
2 sealing because it changed, it lowered its basic rates, it
3 would receive the benefit of the small system exemption in
4 1980--

5 A Yes.

6 Q Even though its circumstances stayed the same, same
7 number of subscribers, same number of DSE's, the only difference
8 is it lowered its rate. So, without this adjustment, the cable
9 system could achieve a benefit of the small system exemption by
10 lowering its rates, all things remaining the same.

11 A That's correct. In other words, the \$150,000 gross
12 revenue in this period, would have brought it below \$160,000
13 level. If you use an average basis for an entire industry,
14 it would be higher than \$160,000 because on the average, rates
15 went up. Therefore, this system would fall into a smaller
16 system category because it lowered its rates.

17 I think it was the intent of the Act and the reason
18 they give you both the inflation and the rate adjustment in that
19 paragraph, where it talks about the gross revenue levels, I
20 think it was the intent that the systems be kept in the same
21 category if they changed their rates. So they get the
22 benefit. In other words, there is no change based on their
23 change in rates in the category.

24 Q So, by making this downward adjustment, the \$160,000,
25 you are maintaining the value of that small system ceiling
to that cable system?

1 A The relation to the cable system , to the ceiling
2 is the same. Right.

3 COMMISSIONER GARCIA: Mr. Korn, how do we come up
4 with the \$42, or are you going to tell us that next?

5 THE WITNESS: I'm sorry. That's the exceptional
6 case. We will get to that last. That has to do with tiering.

7 COMMISSIONER GARCIA: Are you going to show us how you
8 get to that before you start?

9 THE WITNESS: Sure. The next example, which is
10 really the one that you already did on part one, I won't go
11 over that; the subscriber rates remain the same, \$6 in 1976
12 and \$6 in 1981. He, therefore, gets the full effect of
13 inflation. Now, going down to Part two (a), his gross revenue
14 is \$180,000. Line (b), multiplying \$160,000 by line four,
15 above; line four is one, gives you \$160,000. So, his gross
16 revenue borderline stays the same, which is exact intent.
17 In other words, if you went up with inflation, your borderline
18 goes up with inflation correspondingly. If you stay the
19 same, then your borderline stays the same.

20 Line (c) is the same. We are assuming the same
21 number of DSE's and the same royalty rate. The surcharge is
22 simply copied from above, .50. That's line (d). In line
23 (e), we multiply the surcharge by the statutory royalty rate
24 which gives .00763, and the adjusted rate is simply the sum
25 of the two, the statutory rate and the adjustment. You get
.02288, which is the adjusted royalty rate for this particular

1 cable system. The royalty fee due is then multiplied
2 by its revenue which becomes \$4,117. So, you do notice that
3 although the adjusted royalty rate is different in each case
4 for each system, it is compensated for by the revenue gain or
5 loss because it changed its rates.

6 Therefore, you come out with the same royalty fee
7 due.

8 The next example in part one shows the case where the
9 cable system increased its rate from \$6, again in October '76,
10 to \$9 in April 1981. That is in Line four an increase of
11 1.500. Now, when you subtract 1.500 from the inflation rate
12 of 1.500, you would get zero. In other words, by increasing
13 this rate 50 percent, he has kept right in line with inflation.
14 So, he goes to line six. And it says if line five is zero or
15 negative, in this case it was zero, you check here and skip
16 to part two, below, because there is no surcharge. So he
17 checks and he goes below. Now, his revenue was \$270,000.
18 His limit is determined in line (b) by multiplying \$160,000 by
19 line four, above, by one and a half, \$240,000.

20 In other words, his went up strictly with inflation.
21 Going to (c), again, we have the royalty rate and, of course,
22 there is no surcharge in (d). So he pays the old rate. If
23 you would multiply it out against his \$270,000, you would come
24 up with same fixed fee, royalty fee. This is the royalty fee
25 per 5,000 subscribers remember, in each case. So, the royalty
fee per subscriber is the same, too. That is exactly what the

1 Royalty Act say.

2 The next part we have the CPI change of 1.50. And in
3 this case the subscriber rate went from \$6 to \$8, or an increase
4 1.333 in line four. Once subtracted, the result in line five
5 gives you .167. Line 7 converting it to \$81, 81 base, gives
6 you 0.125. That means that there is a 12 1/2 percent surcharge.
7 The calculation below show that the revenue for this
8 system is now \$240,000. When you multiply \$160,000 by line
9 four, above, which is its rate increase, in other words 33
10 percent increase, you get \$213,000. So that would be his
11 borderline.

12 Now calculating the actual royalty below the same way,
13 you can have the fixed royalty fee plus the additional surcharge
14 of .00191. In line (e), it gives you a total of the fee
15 adjusted to .01716. When that is multiplied by the \$240,000
16 revenue, you, again, get \$4,117. Before I go on to the
17 exceptional cases of the zero base, which is what you asked me
18 about, if you have a question, I will be glad to take it.

19 We can go over this and just look at the parenthetical
20 expressions and tell you how you would treat the exceptional
21 cases. Line two is the first one. In other words, normally,
22 you would put your October 1976 subscriber rate there. But
23 if you did not exist in October 1976, your new system, you
24 don't have any.

25 The form tells you to use \$6.60. As a matter of fact,
it doesn't make any difference what that figure is. We just

1 took the industry average, but it does not matter what it
2 is because--I'm sorry. Excuse me. That is only if you had
3 a zero rate. We used the industry average. So you would measure
4 from the industry average. If your system had existed, you
5 are assumed to have the industry average. You are offset
6 against inflation is measured against that.

7 The next important parenthetical expression is not
8 in parenthesis. It says--yes, it is. I'm sorry. On line
9 three it says, "Your April 1981 subscriber rate, if zero, see
10 note below." In other words, if you had a free basic service
11 in April 1981, you use the figures in the note. And what the
12 note says, in line three, in other words for April 1981
13 subscriber rate, use \$6.60 The effect of that is to give
14 the full effect of inflation. If you are on a new system
15 and you came on with a free service, you would use \$6 in line
16 two because your a new system, you had none--\$6.60, also
17 \$6.60 in line three because you had a zero basis. So, you
18 would have a difference, zero, and you would have the full
19 1.5 effect of inflation. There is no offset for inflation.

20 COMMISSIONER GARCIA: Mr. Korn, number three there,
21 when you say zero, you said 60. That's a design to pick up
22 any tiers and free services?

23 THE WITNESS: Exactly, the basic service is free
24 service, the basic tier. What do you do for revenues?

25 COMMISSIONER GARCIA: Excuse me. Before you go
any further, why do we use \$6.60 and '81?

1. THE WITNESS: I just explained that.

2. COMMISSIONER GARCIA: I know, but I did not understand.

3. THE WITNESS: Nobody had free service in October of
4 '76, so, we are talking about new systems.

5. COMMISSIONER GARCIA: Yes.

6. THE WITNESS: A new system, we are told to put
7 \$6.60 in '76 in line two. We are also telling you to put
8 \$6.60 in 81, line three, so that the difference is zero and
9 he will get the full effect of inflation. In other words,
10 you won't have an offset. As a matter of fact, there is a
11 page that shows that. If you look at the second one, if you
12 have the same number instead of \$6, it is the same number in
13 both two and three. Divide one by the other, you would get
14 one. You would end up by getting the 50 percent inflation
15 charge. So, that system you get the actual effect of
16 inflation.

17. However, there is another problem that is taken
18 into account in the note. It says in line (a), "The gross
19 revenues." If a system has free service, it has no gross
20 revenues. Here, we have given it the industry average revenue
21 per subscriber. This is for the six months. That is
22 approximately \$42. In other words, \$6.60 plus six percent
23 for second sets and other revenues, times six. That is \$42
24 for the period.

24. CHAIRMAN BURG: Go over that again please?

25. THE WITNESS: We have taken the average industry

1 revenues per subscriber, estimated as follows: \$6.60 plus
2 a 6 percent factor for second sets and other revenues. That
3 gives you \$7. So, the \$7 times six months is \$42. The notes
4 tell you to use \$42 times the number of subscribers. So,
5 in that way, you construct a revenue base for the systems that
6 had none.

7 BY MR. ATTAWAY:

8 Q Mr. Korn, isn't what you are doing for systems with
9 November 1976 rate and November 1981 rate is require for them
10 to pay statutory royalties on the real constant dollar value
11 of the average royalty rate that did exist in 1976?

12 A On the average revenue, too; revenue per subscriber.

13 Q Right. The per value of that rate?

14 A That is right. In effect, we are constructing a '76
15 base, since we are increasing it to the full effect of
16 inflation. That is exactly what we are doing.

17 MR. ATTAWAY: Before I go on, are there any questions
18 from the Tribunal on these worksheets?

19 THE WITNESS: I might say that I have shown you, you
20 might say on a common sense method, that he actually gives
21 you the same royalty fee per subscriber. I have also
22 you, by example, it comes out to the same per 5,000 subscribers.
23 There is also mathematical proof, I can submit to the record,
24 that will demonstrate that you get the same royalty fee per
25 subscriber by using this method. Now, there may be simpler

1 worksheets that you could do, the effect is the same, if you
2 follow that procedure. Subtract the two increases and use
3 the difference converted to a current base. You can use that
4 difference as your adjustment for your DSE schedule.

5 COMMISSIONER GARCIA: Mr. Korn, go over, again, your
6 computations for that 1.5 starting of the CPI, your very first
7 line one?

8 THE WITNESS: There is no computation for that. You
9 publish that figure.

10 COMMISSIONER GARCIA: Was that on the previous page?
11 Go ahead.

12 THE WITNESS: You want to know where that comes from?

13 COMMISSIONER GARCIA: Yes.

14 THE WITNESS: 1.5. The CRT issues a notice--

15 COMMISSIONER GARCIA: I mean this is just an example
16 you have given us, right?

17 THE WITNESS: Yes. This is for future times. I
18 just picked it out of the air. Right now it is only 1.399.

19 COMMISSIONER JAMES: You have mathematical justifica-
20 tion that you can submit?

21 THE WITNESS: Yes.

22 COMMISSIONER JAMES: I think I would like to have
23 that.

24 THE WITNESS: We are going to another thing.

25 COMMISSIONER JAMES: Mr. Korn, did you review the
pleadings by NCTA earlier this year in this proceeding?

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THE WITNESS: Yes, I did.

COMMISSIONER JAMES: Is it your understanding
that NCTA interpreted 81(b), 2A differently than the way
you interpreted it and have described here today?

1 THE WITNESS: Now, the Act says the adjustment is to
2 maintain the real dollar level of the royalty fee per sub-
3 scriber which existed at the date of the enactment of the act.

4 Now, as used here, I have interpreted royalty fee
5 per subscriber really as royalty fee per subscriber for any
6 given number of DSEs. It appears to me that NCTA interprets
7 this as royalty fee per subscriber in dollars no matter how
8 DSEs are being used.

9 I believe my interpretation is correct for several
10 reasons. On the date of the enactment of the Act, there was
11 no royalty fee in dollars; their gross base royalty fee. So,
12 continuing certainly could not have implement the royalty
13 fee in dollars that had to be kept constant but there was a
14 DSE schedule which was setup. That is the thing that has to
15 be kept constant. The value of the schedule when I applied
16 to revenues under the NCTA interpretation, a cable system that
17 holds its subscriber rate down for business reasons can in-
18 crease the number of DSEs up to the rate of inflation--

19 MR. FELDSTEIN: Madam Chairman, pardon me for the
20 interruption.

21 In addition to the legal interpretation of the Act
22 which a person who has been qualified has been given, he is
23 making purchases by NCTA which has not been given. It is
24 going to be difficult to cross-examine him.

25 THE WITNESS: May I, instead of calling it the
NCTA interpretation, call it where you talk about royalty fee
in dollars rather than royalty fee schedules.

CHAIRMAN BURG: Let's restructure this line of
testimony to compare the way we have interpreted this section

1 which is to say royalty fee per subscriber given a constant
2 number of DSEs against a different interpretation that may
3 or may not be made by NCTA that the statute means to say
4 royalty fee subscriber without regard to the number of DSEs
5 is carried by a cable system or without regard to the number
6 of programs not DSEs. DSE is a short way of saying program-
ming here.

7 MR. FELDSTEIN: Counsel is attempting to rebut NCTA's
8 case prior to NCTA making it. Counsel will have every oppor-
9 tunity to rebut our case after we have made it as counsel
10 for NCTA has stated. We don't know what their case is. We
11 have not seen it yet. We suspect, based on their previous
12 submission, there may be arguments to this effect and we
13 would like to compare our interpretation with another inter-
14 pretation that may be made or that the Tribunal itself, maybe,
made.

15 CHAIRMAN BURG: The Tribunal will overrule that
16 objection.

17 Proceed.

18 THE WITNESS: So, the first confirmation. I would
19 say that our interpretation is correct is that the Act refers
20 to the fee which existed at the date of the enactment of the
act. That could not mean a dollar fee because there was none.

21 Secondly, a cable system by holding its subscriber
22 rate down for any reason shall, probably, business reasons,
23 can increase the numbers of DSEs carried with no penalty up to
24 the inflation rate if the interpretation discussed is the one
25 that you adopt.

1 Under this interpretation, it is possible to add
2 DSEs whenever subscriber rates are lowered. If they decide
3 to go to a lower subscriber rate or a zero subscriber rate,
4 they can add an additional DSEs without an additional
5 royalty payment.

6 I don't believe this was the intention of the Act
7 which requires a separate rate payment for every DSE on a
8 calculated graduated scale which is made quite clear in
9 Section 111(d)2B.

10 Now, this point is very important now because there
11 is greater interest in using DSE because of FCC removing these
12 restrictions. Therefore, I believe the required adjustment
13 is one that increases the DSE percentage schedule to keep
14 pace with inflation after given credit for the increase in
15 subscriber rates.

16 If the rates go up faster than the CPI, there would
17 be no adjustment.

18 CHAIRMAN BURG: Under your recommended interpreta-
19 tion in your formula, is it true that copyright owners will
20 receive the same, the 1976 constant dollar value of the
21 royalty payment prescribed by the statute for the programs
22 that are retransmitted by cable systems?

23 THE WITNESS: Yes, sir.

24 CHAIRMAN BURG: If an increase in the change of
25 DSE programs is added to the waiver increase in rates, there
may be, during the period between 1976 and 1980 and then
adjusted to its present value, real constant dollars because
there would be an increase in the programs carried, won't
copyright owners receive less per program than they

1 would under your interpretation?

2 THE WITNESS: Yes. The constant value, the con-
3 stant dollar value, of the royalty fee per subscriber per
4 program would decrease because the number of programs carried
5 would increase without any charge.

6 MR. ATTAWAY: This concludes my questions.

7 CHAIRMAN BURG: Would you briefly list the recom-
8 mendations that you have made to the Tribunal during your
9 testimony.

10 THE WITNESS: Yes.

11 I think if you pass out Exhibit 17, they will have
12 it right in front of them.

13 COMMISSIONER JAMES: He is going to give a summary
14 now?

15 MR. ATTAWAY: Yes.

16 COMMISSIONER JAMES: I have been working with my
17 calculator and I am confused about something. If you take
18 Exhibit 14 and apply it to your example, what would that fee
19 be, that that cable system would pay, that has 5,000 sub-
20 sscribers?

21 THE WITNESS: I'm sorry. What is the question?

22 COMMISSIONER JAMES: That was the straight adjust-
23 ment across industry-wide.

24 THE WITNESS: Yes.

25 COMMISSIONER JAMES: If you applied that to your
example, what would that cable system of 5,000 subscribers
pay in royalties?

THE WITNESS: Well, how many DESS does it carry?

COMMISSIONER JAMES: You have three; right?

1 THE WITNESS: Use the same assumption as on here.

2 COMMISSIONER JAMES: Yes. Use the same assumptions
3 you have on 16.

4 THE WITNESS: We have to figure out the revenues.

5 COMMISSIONER JAMES: 240,000.

6 THE WITNESS: No. 760 is the April, 1980, seven
7 point sixty times the six, for six months, times 5,000; right?

8 So, the revenue is 228,180; is that correct?

9 COMMISSIONER JAMES: I don't know. I was having
10 problems. That is why I asked you to help me with it.

11 THE WITNESS: Let me go over it again. The revenue
12 was the 1980 rate of \$7.60, 7.60 times six months, that is,
13 and multiply that by 5,000 subscribers. That's 228, 180 in
14 revenue.

15 If three DSEs is zero one. No. What is three DSEs?

16 COMMISSIONER JAMES: Five two five?

17 THE WITNESS: Right. The surcharge on this is 2152;
18 two one five two, .01525 times 1.2152. So, it is rated on
19 three DSEs which is 1.8531. That is percent.

20 COMMISSIONER GARCIA: Why don't you do it on the
21 board for him?

22 THE WITNESS: It might be helpful to write it on
23 the sheet.

24 If you look at Exhibit 14 where it says for three
25 systems, schedule form three systems, add 21.5 percent to the
DSEs. They don't have to be DSEs on here. So, let's write it
on; three DSEs. The original rate is .10525 adding 21.5
percent to that. If my calculation is right, I'll do it again,
we can write in 1.8531. That's the new rate.

1 The other figure that is missing is the gross
2 revenue figure. As I said, we constructed that by taking
3 the monthly cable rate and using that as your base. So, I
4 reconstructed that by multiplying the cable rate of 7.606, in
5 the first line for April, 1980, by six months and by 5,000
6 subscribers and I get 228,180 dollars.

7 When I multiply the revenue by the new DSE figure
8 of 1.8531, I get \$4,228 as a royalty fee.

9 COMMISSIONER JAMES: Play that by me. Maybe you
10 can put it up on the board.

11 MR. ATTAWAY: Let me run through it by asking ques-
12 tions.

13 BY MR. ATTAWAY:

14 Q In Exhibit 14, you hypothesized an increase in DSEs of
15 15.150 percent and an increase in the CPI of 39.931 percent.

16 A 15.150 percent is increase in cable subscriber
17 rates.

18 Q Right. You calculate a surcharge of .2152. Now,
19 if this were applied on an industry basis, go to your first
20 sheet of Exhibit 16, the cable system rates were lowered, and
21 their growth 1981 revenues would be \$150,000. You have
22 already calculated its DSE or its DSE percentage assuming
23 throughout this hypothetical cable systems are carrying three
24 DSEs to keep it constant .0125 percent is what it equals.

25 If there was an industry-wide adjustment, won't you
then multiply that percentage for three DSEs under the
statutory schedule by your adjustment of 1.24781 and apply
that adjusted percentage against the gross revenues of \$150,000
and you would get a royalty payment of \$2,779; is that correct?

1 A I did not follow it,

2 . COMMISSIONER JAMES: I think he has asked the exact
3 question that I wanted answered.

4 BY MR. ATTAWAY:

5 Q In Exhibit 14, you worked an industry-wide sur-
6 charge; right?

7 A Correct; 21-1/2 percent.

8 Q 21-1/2 percent.

9 A Right.

10 Q If you then take the example in Exhibit 16--

11 A [interposing] Which example?

12 Q The first sheet. The system that had \$150,000 of
13 gross revenues in '81.

14 A Right.

15 Q And multiply its DSE percentage, .01525, times the
16 surcharge. To save a step multiply it by 1.2152, take that
17 percentage of \$150,000. That becomes its adjusted royalty
18 rate.

19 A That's correct.

20 Q Times \$150,000.

21 A Right.

22 Q What do you get?

23 A 2779.

24 Q That is what this system would pay--

25 A [interposing] On an average industry basis.

COMMISSIONER JAMES: May I stop you there. Going
back to 14, wouldn't that system at \$150,000 fill out a form
two.

MR. ATTAWAY: That is correct. In this example, if

1 there is an industry-wide adjustment, this system having the
2 same number of subscribers, carrying the same number of DSEs
3 would drop into a lower category.

4 COMMISSIONER JAMES: That figure that that system
5 would pay is \$2,000.

6 MR. ATTAWAY: It would pay much less than that be-
7 cause it pays the statutory percentage for small systems which
8 you don't have the authority to adjust. They stay the same.
9 So, they would be paying something less than one percent.

10 They would be paying .5 percent on the first \$80,000
11 and one percent on the remainder.

12 MR. COOPER: \$15 for the first \$41,500 and pay the
13 .8 on the balance between \$41,500 and \$150,000. That is
14 the statute.

15 MR. ATTAWAY: They would not be paying on the DSE
16 formula. They would be paying under the formula for small
17 systems whatever that would be.

18 COMMISSIONER JAMES: What is the witness' answer?
19 How much would this system pay under applying Exhibit 14?

20 THE WITNESS: Applying Exhibit 14 and assuming they
21 pay on a form three basis, 2779.

22 COMMISSIONER JAMES: We know they don't pay on a
23 form three. So, it would be less than that even.

24 THE WITNESS: It would be reduced on a form two
25 basis whatever that statutory figure is.

BY MR. ATTAWAY:

Q Just for the sake of illustration, can we run

nlw-9

1 through it one more time on a different example?

2 Take the system making the \$270,000 for January to
3 June, 1981. Now, applying your example 14 to that growth
4 figure, would you work this calculation out and tell me
5 exactly what that system would pay?

6 THE WITNESS: The adjusted DSE percentage is .018531
7 on an industry basis.

8 BY MR. ATTAWAY:

9 Q How did you arrive at that?

10 You took the industry adjustment from 14 times--

11 A [interposing] 21 percent more than the statutory
12 figure.

13 Q Okay.

14 A That figure time the \$270,000 revenue base. The
15 answer would be \$5,003.

16 Q That is what that system would pay if you used the
17 industry-wide?

18 A Right.

19 Q Under an industry-wide basis, that system would
20 pay more than under your formula.

21 A Yes. Obviously, the entire industry is faced with
22 inflation and this example of the cable system actually keeps
23 pace with inflation.

24 Q It has to pay a surcharge even though its rate kept
25 up with inflation.

A Right.

Shall we go on?

Q Yes.

A To summarize the testimony, I would recommend that

1 you use the CPI despite its faults because it is like demo-
2 cracy, it is better than any other system. To maintain a
3 real constant dollar level, adjust the DSE schedule and not
4 the dollar royalty amount, require individual adjustments for
5 each cable system not an overall industry adjustment, use a
6 simple worksheet that gets credit for subscriber rate in-
7 creases against the increases in CPI which also solves the
8 problems of systems that have reduced their rates, new sys-
9 tems that have no base subscriber rate and systems that have
10 a free subscriber use of the basic service.

11 I also recommended that the CPI adjustment should
12 be made every reporting period and not every five years.
13 This prevents substantial royalty loss for copyright owners.
14 It also prevents shocking cable systems by sudden jumps in
15 royalty fees that they may not have planned for.

16 With respect to tiered services, we did not really
17 discuss that but any tier services that include secondary
18 transmissions, I understand that their revenues, I'm recom-
19 mending that their revenues should be counted. I understand
20 that their total DSEs are now supposed to be counted.

21 Q Mr. Korn, you will prepare this evening and make
22 available to the Tribunal your calculations on the short fall
23 and royalties if a semi-annual adjustment is not made until
24 1980, and, also, your calculations demonstrating the mathe-
25 matics of the constant dollar formula that you are recommend-
ing; mathematical proof of its accuracy.

A Yes.

MR. ATTAWAY: That's all the questioning that we
have, Madam Chairman.

1 MR. FELDSTEIN: Would you be planning to go
2 straight across or break at some point?

3 CHAIRMAN BURG: I am proceeding on the assumption
4 that your cross-examination will take your estimated, what you
5 estimated yesterday of half an hour.

6 MR. FELDSTEIN: It is a quarter to noon.
7 We could get into it if you would.

8 CHAIRMAN BURG: I am not going to limit you to the
9 half hour. This seems a little early to conclude the morning
10 session.

11 MR. FELDSTEIN: I would like to preliminarily raise
12 one legal point; that is, in Exhibit 17, which is the summary
13 of Mr. Korn's testimony, he states that, having not mentioned
14 it at all in his testimony, he talks about tiered services
15 and makes a couple of points about total revenues and DSEs. I
16 would move that that testimony and those points be stricken
17 for two reasons.

18 One is that this is clearly outside the purview of
19 the provision under which the Tribunal is now conducting this
20 proceeding.

21 Secondly, it may well be more appropriate for the
22 copyright office and therefore, be totally outside the
23 authority of the Copyright Royalty Tribunal.

24 MR. ATTAWAY: Madam Chairman. Mr. Korn did men-
25 tion these points although briefly in his concluding statement.

As to the authority of the Tribunal, this proceed-
ing is to permit the Tribunal to make adjustments for changes
in charges and the rates charged to subscribers.

Tiering is an example of how cable systems are

1 altering their charges to subscribers, I do think that this
2 Tribunal has authority to review these changes.

3 It might be that the copyright office would or has
4 already ruled on this issue, I think it is also before the
5 Tribunal.

6 MR. FELDSTEIN: I think it is relevant that the Tri-
7 bunal look at how these things are treated possibly in
8 making their adjustments, but I do not believe it is within
9 the purview of the Tribunal's authority as to how these matters
10 should be treated by a cable system.

11 CHAIRMAN BURG: Mr. Feldstein, we will note your
12 objection.

13 Mr. Feldstein, you may continue.

14 CROSS-EXAMINATION

15 BY MR. FELDSTEIN:

16 Q 'Mr. Korn, I want to direct your attention to your
17 Exhibit 14 which contains your inflation figures and a one
18 time adjustment, calculation. At the bottom where you talk
19 about "New Borderlines for Smaller Cable Systems," you use a
20 15 percent rate increase in your example, 1.1515; is that
21 correct?

22 A Yes.

23 Q Based on the data which was presented yesterday by
24 Mr. Cooper--

25 A That is correct.

Q --in your methodology, on an individual system
basis, would you be using that figure for each system or would
you be using each individual system's rate increase as the
measurer?

1 A Each individual system.

2 Q You would use each individual system.

3 A Each system would file its own rate figures. The
4 worksheet would automatically use their own subscriber rate
5 changes.

6 Q In that case, wouldn't the difference result for
7 each system because they would have a rate increase history
8 tend to put each system in different categories despite the
9 fact that they might be the same size?

10 A By "size", you mean what?

11 Q If the system had 2500 subscribers and its rate
12 went up 10 percent and another one's went up 18 percent and
13 you multiply it out by your method, you could have someone
14 in a form one category and someone in a form two or you could
15 have someone in a form two and the other one might get bumped
16 into a form three even though they are the same size.

17 A No. The category is not determined by the number
18 of subscribers. It is by gross revenue.

19 Q That's right, but what if its gross revenues
20 factored out to in excess of the statutory amount for that
21 category?

22 A If its gross revenues changed.

23 Q Because of his rate increase.

24 A Then the borderline would change accordingly. He
25 would still be in the same category.

Q The borderline would be different for each system.

A Exactly.

Q How do you pick the system size?

A Are you talking about gross revenues?

1 Q Number of subscribers.

2 A The borderline is set by gross revenues not by
3 number of subscribers.

4 Q The borderline in the statutory is set by gross
5 revenues; correct?

6 A What was that?

7 Q The borderline is set by \$80,000 for example.

8 A The \$80,000 will change for each system depending
9 on how much it increased its rate. If the rates did not
10 change at all, the \$80,000 would be the same for that system.

11 If it increased its rates, say, by 40 percent,
12 then the \$80,000 would go up by 40 percent.

13 Q How does it stay in that category? I mean where
14 do you start from?

15 A I don't follow.

16 Q Are you taking 76 systems and just letting them
17 move along with the category?

18 A No, they are moving along with their own change in
19 subscriber rates.

20 Q So that a system---

21 A [interposing] So that a system would go out of
22 another category by adding additional subscribers.

23 Q I thought we don't count the number of subscribers,
24 just gross revenues.

25 A You wanted to know how?

Q So it is conceivable that someone could carry with
the same number of subscribers he has today, to carry him-
self along as a form two or forever, with a massive amount
of revenues. Whereas, another system with a much smaller

1 amount of revenues is in a form two.

2 A Wait. No, that is not conceivable.

3 If you had a massive amount of revenues, he would
4 be in a form three category.

5 Q From a rate increase.

6 A Remember it changes rate increase.

7 Q Yes.

8 A But there is a ceiling on that. If he changes his
9 rate increase so he exceeded the inflation right--

10 Q He does not exceed.

11 A Then it is not massive.

12 Q How about a new system that comes into being. We
13 have a system with 2,000 subscribers, continually is raising
14 its rates and you now got him up instead of \$80,000, his form
15 one ceiling, is now \$137,000. You carried him right along
16 and he is still in form one.

17 A new system comes along instead of with these
18 high rates with a \$7 rate, he has got the same number of sub-
19 scribers. He multiplies himself out own his gross revenues
20 and he exceeds the \$80,000 in the statute, which means he
21 pays a higher rate; is that correct?

22 A I have not addressed myself to new systems as far
23 as the rate levels are concerned.

24 Q In other words, systems of the same size. What you
25 are saying then is systems of the same size depending on when
26 they started and what their rates were might be in different
27 categories, form categories?

28 A No, I said I didn't address that question as far
29 as the borderline rates are concerned or borderline gross

1 revenues are concerned.

2 Q If you were to use a systemwide, an industrywide
3 approach to the small cable systems, you would have to use,
4 your interpretation the average, was not Mr. Cooper's rate
5 data for DSEs paying systems.

6 A Yes, it was.

7 Q Therefore, this would be an improper average to
8 use here since we are referring to smaller systems.

9 A I understood that the overall averages--

10 Q [interposing] You didn't testify to that nor did
11 Mr. Cooper.

12 A Yes, he had several different averages.

13 Q Did Mr. Cooper's; the rates that he was relying on,
14 the CRT survey--

15 A [interposing] I know his survey was only performed
16 for form three systems.

17 What I was saying on that same exhibit there were
18 other service which seemed to have consistent figures which
19 included other than form three systems.

20 Q In this small system, system by system adjustment,
21 some kind of a worksheet plus instructions plus the semi-
22 annual adjustment would be needed to be sent to all systems
23 I presume in the small category.

24 A No. The semi-annual rate adjustment is not neces-
25 sarily for that. That would be published by the CRT.

Q Presumably a system, until he worked this out, would
not know whether he was in form one, two or three; would he?

A That's correct.

Q Now, presently, the copyright office knows which

1 form these people are in. If they change, they let them know.
2 They mail them the proper form or do they mail them all three
3 forms and say choose what is proper for you?

4 A I don't know. On the present form, there is a
5 sentence that says if you don't hit this figure, go to the
6 other form.

7 Q They would have to recalculate that each time.

8 A They would handle it the same way as presently.
9 When they find they are in the wrong bracket, the instruc-
10 tions refers them to the other form.

11 Q On top of the same page of Exhibit 14, where you
12 have your inflation information, you use April, 1980. Why
13 have you choose April, 1980?

14 A I chose April, 1980, because it is the middle of
15 a six-month period and it was the lastest six-month period
16 for which we had figures available.

17 The CRT questionnaire had the corresponding cable
18 rates available, and I figured I would use those inspite of
19 the fact they are only form three systems since it was the
20 lastest available information.

21 Q Didn't the CRT survey asked people what rates were
22 in April 1, 1980?

23 A I am not sure, if you say so.

24 Q If that is so, wouldn't the more proper end measure
25 have been, it is not the CPI, published once a month?

26 A The CPI is published once a month and is supposed
27 to represent the entire month.

28 Q Therefore, would not the more appropriate measure,
29 end measure, not be April, 1980, but March, 1980?

1 A It is a toss up between March of 1980 and April.
2 The reason I chose April, frankly, was that the CPI sometimes
3 has a two-month lag. Part of the price data is collected
4 monthly and part of it is collected bi-monthly.

5 Q You stated that your system by system approach
6 applies to what might happen in 1980-1985 which is interesting
7 in light of the Tribunal's looking at '76 to '80 with all
8 this other data.

9 In your approach, therefore, you admitted, theoreti-
10 cally, is it not, you stated that in your testimony.

11 A Exactly what are you referring to. I am not sure.
12 You say my approach to what?

13 Q You stated that your system by system approach that
14 you went through on your worksheets was based on theoretical
15 assumptions.

16 A Yes.

17 Q Is there any data to support what will happen between
18 1980 and 1985?

19 A You mean the assumptions to 1. 50--

20 Q [interposing] No. As to what systems might do.

21 A This is not to represent what systems might do.
22 This is an example of a particular system, and I took the
23 example, selected the example, so data would be consistent
24 for the four different examples.

25 Q Do you believe that the Tribunal should be put in
26 the position of estimating or guessing as to what the develop-
27 ments might be in the next five years?

28 A No. I think that they should design their proce-
29 dures so that, as best they can, take into account whatever

1 might happen. Yes.

2 Q You have shown a great solicitousness for the fair-
3 ness of your system by system approach of cable television
4 systems. Doesn't the 1976 Act apply to same royalty rates
5 to otherwise identically placed cable systems who have dif-
6 fering basic subscriber rates?

7 A I am sorry. I did not understand. You said I was
8 solicitous about the cable systems--

9 Q [interposing] Your approach and you stated is sup-
10 posed to be fairer than the cable system plan. I am asking
11 you under the 1976 Act approach, the approach that is, the
12 law and is applied right now and has been done on all the
13 forms which have been filed thus far--

14 A [interposing] You are confusing me. Can you tell
15 me or are you talking about the gross revenue limits or what?

16 Q No. I'm talking about the application of the per-
17 centages.

18 A Then I wasn't solicitous of the cable systems about
19 that.

20 Q I am not asking you that. I am asking about the
21 1976 Act as it is applied to the cable industry, does it not
22 apply the same percentage rates whether on a DSE basis, well,
23 on the DSE basis, does it not apply the same rates to systems
24 no matter what their monthly subscribers fees are?

25 A Well, the same rates, but it does not give you the
same results because subscriber fees are reflected in the
revenues. So, therefore,--

Q My point is if a system with 5,000 subscribers in
three DSEs, one charged \$6 for a basic rate and one charged

1 A Yes.

2 Q That's based on the average-- May I hear your
3 answer; yes or no.

4 A Yes.

5 Q This approach is part of an individualized system
6 approach; is that correct?

7 A Yes.

8 Q Are you recommending imposing an industry average
9 for post-1976 systems on an individualized approach?

10 A Do you want me to answer that now?

11 Q Yes.

12 A For those systems that went into operation after
13 1976 and who also have a zero base at present, which is the
14 ones you are asking me about, it does not matter what figure
15 you put in there, whether \$6.60 or anything because they are
16 getting the full effect of inflation.

17 The only affect would be, on an average basis, of
18 giving them the revenue base of the average.

19 Q All I am asking you is whether you have used an
20 average, an industry average, imposed on an individual system
21 approach.

22 A For those systems that went into effect after '76,
23 yes.

24 Q For those systems since you assume in October, 1976,
25 date and an October, 1976, rate, and then move to an April,
1981, date, aren't you imposing a full four years of inflation
on such systems even though they may have begun operation any-
time up until the beginning of 1980?

A I am not imposing the inflation. The real constant

1 \$9 for a basic rate, the person who is paying on his copy-
2 right royalty fees on the \$9 rate pays more copyright royalty
3 fees than the person who has the \$6 basic rate; is that cor-
4 rect?

5 A The system that has the \$9 royalty rate.

6 Q The \$9 basic rate.

7 A --basic rate, pays a higher fee than the one who
8 pays the \$6.

9 Q Is that correct?

10 A Sure.

11 Q In other words, the rates established in the 1976
12 Act, royalty rates, were based on average basic subscriber
13 rates; is that not true?

14 A The royalty rates are percentages.

15 Q Based on-- Since the Congress was attempting to
16 raise a particular amount of money, where they not, establish-
17 ing those royalty rates to be applied against basic subscriber
18 rates, gross revenues, if you will, in the full knowledge
19 that different subscriber rates were charged by different
20 systems?

21 A Yes.

22 MR. ATTAWAY: Madam Chairman, I have to object to
23 the statement that Congress was trying to raise a particular
24 amount of money. I don't think that has been established in
25 this testimony. I don't think it is true.

BY MR. FELDSTEIN:

Q You have alluded to the statute today.

CHAIRMAN BURG: Are you talking in response to his
objection?

1 MR. FELDSTEIN: The witness recommended an individual-
2 lized calculation. I'm trying to establish the fact that no
3 individualized approach existed or exists under the '76 Act.

4 COMMISSION BRENNAN: The objection goes to the
5 foundation to your statement that Congress was seeking to
6 raise a particular sum of money. That has not been established
7 in this record.

8 MR. ATTAWAY: If it will help, counsel for
9 NCTA, I will stipulate that the statutory rates apply equally
10 to all systems no matter what they charge.

11 MR. FELDSTEIN: Thank you.

12 BY MR. FELDSTEIN:

13 Q You have quoted and read from the provision under
14 which the DSE system adjustment is to be, under which this
15 adjustment is to be made, 801(b)2A.

16 In one of your worksheets, you alluded to the fact
17 that the system might, by lowering its rates, drop its gross
18 revenues below the limitations provided for in the statute
19 for short forms and thereby move from form three into a lower
20 category.

21 A Under my system, the borderline would lower in pro-
22 portion and they would not be able to do that under my work-
23 sheets.

24 Q For post-1976 systems, that is systems who go into
25 operation prior to October, 1976, that is, new systems-- I
am sorry. Correct that. I meant systems who went into
operation after October, 1976, the new systems, there was
no rate for subscriber rate, they gave basic away, you have
made a \$6.60 assumption in terms of 1976 rates; correct?

1 value of the dollar is that in 1981, it is CPI that determines
2 what kind of dollars they pay in. It is not determined by
3 what time they go into business.

4 Q Why should earlier years inflation be imposed on a
5 system that began operation December, 1979?

6 A I look at it as them paying the royalty fee in the
7 constant dollar equivalent to what it was in 1976. That is
8 what the act says. It does not make a specific case of new
9 systems.

10 Q There are often marketplace factors as to why rates
11 are set at a particular level. Let's assume a CATV operator
12 who began operation prior to 1976, and set his rates at \$4
13 and by 1980, his rates are now \$6. Under your assumption,
14 under your work sheets, since he had a 50 percent increase in
15 his basic rates, he has no surcharge; is that correct?

16 A It is not just my assumption. The act itself says
17 that.

18 Q The fellow comes along who has the same kind of
19 system in the same kind of city and for the same marketplace
20 reasons put his basic fee at less than, say, an average rate
21 and has no rate increase to show because he just began an
22 operation, he is going to have a large inflation surcharge is
23 he not?

24 A Is this a new system?

25 Q Yes.

A That starts and has a lower rate, less than average
rate.

Q Yes.

A But had no subscriber rate in 1976?

1 Q Correct.

2 A You measured from industry average in '76 to what
3 he has now. He would have a surcharge on that. Yes.

4 Q These two systems might conceivably have the same
5 rate now but one has a surcharge and one does not.

6 A That's your example.

7 MR. FELDSTEIN: Why don't we break and resume
8 at 2:00 o'clock.

9 [Whereupon, at 12:15 p.m., a lunch break was
10 taken to resume at 2:00 o'clock, p.m.]
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AFTERNOON SESSION

1 CHAIRMAN BURG: We are on the record.

2 Mr. FELDSTEIN, You may proceed.

3 MR. FELDSTEIN: Thank you.

4 CROSS-EXAMINATION (Continued)

5 BY MR. FELDSTEIN:

6 Q Mr. Korn, you have recommended that each cable
7 system should adjust its copyright royalty payment for infla-
8 tion individually in each six-month reporting period.

9 A Right.

10 Q Assuming that inflation exceeded basic rate increases,
11 this would produce an increase in an individual cable systems
12 copyright cost; is that correct?

13 A If it has the same revenue base, yes.

14 Q If the cable operator wanted to be able to recover
15 this increased cost, and he was a rate regulated system, he
16 would have to frequently enter into the arena of asking for
17 rate increases from his regulatory body; is that correct?

18 A Well, I assume that the question of whether he
19 wants a rate increase would consider a lot more things than
20 the growth of the small amount of penalty has on royalty fees.
21 It is a merchandising decision. Of course, one item would be
22 the cost of the signals. Right.

23 Q Your approach, would it not, deny the cable operator,
24 cable industry, the opportunity for a hearing before the CRT
25 demonstrate the effects of regulatory restraint and/or other
extenuating factors both which are, seemingly, provided for
in the Act?

A On the contrary, I think unless you handle it on an

1 individual basis, you can't really get at those questions.

2 In other words, if an individual system is claiming
3 some extenuating circumstance, I don't see how you would get
4 at it if he has to file on an average basis.

5 Q Are you then saying that there would be an individual
6 hearing for a system which had a problem before this Tribunal?

7 A I don't know how it would be handled legally but
8 certainly if there are extenuating circumstances that are not
9 general to the industry and I don't see any general such
10 circumstances, they would have to be taken up individually. I
11 just don't know what the method would be of doing it.

12 Q With 1,050 DSE paying systems and this adjustment
13 every six months, you would envision some kind of ad hoc
14 mechanism for each system.

15 A I don't envision really much activity in that area.
16 It appears that the extenuating circumstances that the Act had
17 in mind apparently did not occur from what I heard yesterday.
18 The Congress is apparently afraid that some system is going
19 to be squeezed by its own franchise city or something and did
20 not want the CRT to give it the last push, but obviously since
21 that time with the movie channels and the additional channels,
22 pay channels, those circumstances don't exist. So, I see very
23 little use for that.

24 Q Mr. Korn, do you believe that every system has those
25 kinds of channels on it?

26 A I think most of them do and within a few years, they
27 all will.

28 Q Are you saying if a particular system had a regula-
29 tory restraint problem that that individual system and any

1 other individual system so situated would have to come in
2 possibly on a semi-annual basis to demonstrate its problem
3 to the Tribunal?

4 A Yes.

5 Q Mr. Korn, under the current scheme in place and
6 operating at the present time, if the Copyright Office wants
7 to monitor or check correctness of the calculations, it need
8 only look at a system's basic gross revenues, the number of
9 DSEs and see whether the calculation is made correctly; is
10 that correct?

11 A Yes.

12 Q Under your proposal and assuming that the Copyright
13 Office wanted to supervise cable copyright payments as the
14 forms came in and they checked them over, would it not also
15 have to make separate individual determinations as to the
16 basic rates in '76, the rates now, inflation over the same
17 period as well as the number of DSEs carried and the basic
18 revenues received?

19 A Well, the inflation rate, of course, is given to
20 everybody. That is the same for everybody. The number of
21 DSEs scheduled that would have to be checked in either case
22 under either system. Rather than substituting for revenues,
23 you are substituting for cable rates.

24 I feel that the cable rates are more able to be
25 obtained. If copyright decides to do all the checking, per-
haps the copyright owner could do checking by comparing the
cable rates shown there with the fact book or whatever.

Q The fact book is annual. Wouldn't they also have
to know the basic rate at the beginning and end of the semi-

1 annual period?

2 A I'm sorry. Who would have to know?

3 Q The Copyright Office.

4 A Yes.

5 Q They would have to know the basic rate.

6 A The Copyright Office would have it because it would
7 be submitted by the cable company. Yes.

8 Q Wouldn't they have an extra set of calculations
9 to check, the several calculations which are included in your
10 worksheet?

11 A Yes, but they can be simplified. I prepared the
12 worksheet to be in logical order, but there is another formula
13 that will do it on a calculator at no time at all.

14 Q Would this conceivably not have to be done for all
15 of the thousand fifty in the DSE category?

16 A If someone wanted to check the arithmetic, it could
17 be done. I don't know that they are now. If they are, the
18 same amount will work.

19 Q In your calculations in your worksheets, you spoke
20 of whether the basic rate; that is to say, are you referring
21 this to the basic monthly charge that a cable system imposes
22 on a subscriber?

23 A That's what I would use. That is what I would read
24 the provisions of the Act as saying.

25 Q Have you included in that revenues which might,
other revenues, which might be obtained for retransmission
from a subscriber such as connections to additional sets?

A Section 801 speaks about Subscriber Rates and it
seems to me it uses it as a proxy for average revenue per

1 subscriber. It probably would be better to use average
2 revenue per subscriber to make it work perfectly, but in view
3 of the fact that Section 801, more or less, directs the use
4 of subscriber rates as a proxy not too much is lost because
5 my understanding is that the other charges are usually pro-
portional to the basic charge in any case.

6 So, let's say they were 10 percent higher. It
7 would not make any difference whether they used the figure
8 that's 10 percent higher in 1976 and 1980.

9 Q Would it make a difference if more homes took an
10 additional set?

11 A No, because you are on a per subscriber basis here;
12 proportionally more, yes; not more homes.

13 MR. FELDSTEIN: That concludes cross-examination.

14 CHAIRMAN BURG: Thank you, Mr. Korn.

15 MR. ATTAWAY: I have redirect.

16 CHAIRMAN BURG: All right.

17 REDIRECT EXAMINATION

18 BY MR. ATTAWAY:

19 Q Mr. Korn, during the luncheon break, I understand
20 you made some calculations to further answer the questions
21 of Commissioner James. Unfortunately, Commissioner James is
22 not present, but for the benefit of the other members of the
23 Tribunal, you might demonstrate to them the actual difference
24 between the industry-wide adjustment and the cable system by
cable system adjustment using the hypothetical cable systems
that you used in your worksheets that you handed out earlier.

25 A These are the same worksheets except that I filled
them out during the lunch time. The same ones you have with

1 extra scribble on it to show what the overall industry average
2 would be.

3 Of course, this worksheet was prepared originally
4 to represent a period of, the first period of 1981. The
5 Exhibit No. 14 was for a period, first period in 1980. So,
6 they are different periods, and, therefore, the increase that
7 we got in Exhibit No. 14 of 21-1/2 percent surcharge for
8 inflation, the net industry figure, is for a different period,
9 but assuming that the same ratio applies for the latter
10 period, I have calculated on these worksheets what were the
11 actual royalty fee being under those assumptions.

12 Looking at the first sheet, the first change is made
13 down in line "B", the bottom of the page. The \$160,000 limit,
14 instead of being multiplied by line four above is now multiplied
15 by the industry, the average, which is one point to 152. I've
16 done the arithmetic. It is \$192,432. Therefore, this system
17 which only had 150,000 gross is considered to be a smaller
18 system. If a smaller system would pay on the following basis,
19 if you will note the scribbling, the \$80,000 limit now becomes
20 97216 by multiplying by the same factor.

21 The statute requires us to pay half of one percent
22 of that which is \$486, and for the amount over that which is
23 52784, one percent of that which is \$528 for a total fee of
24 a \$1,014.

25 So, this system under the assumption we've made
would now pay, not as a schedule three system any more, but
would pay a total of \$1,014 instead of the \$4,117.

On the next page, I've done the same thing for a
system that did not increase at all in its rates. Going down

1 to line "B", again, it is the same calculations. Actually
2 it is the same fee because this system is only 180,000 below
3 the 194,000 new industry limit. So, therefore, this system
4 would now pay based on this revenue \$486,000 for the first
5 47216 and 828,000 at one percent for the balance for a total
6 of 1,314 dollars compared to the 4117.

7 On the next page, I have not shown line "B" because
8 the 270 is over the 194,000. This system has to pay on the
9 DSE schedules.

10 Now, what does it pay?

11 If you go down to line "D", instead of none, it
12 would pay the industry average of .2152 which is .003 points
13 more on the royalty rate for total royalty rate of .01853.
14 When you multiply that by the 270,000, you get \$5,003
15 compared to the original sheet which showed 4117.

16 Finally, on the last example where this system
17 actually increases rates from \$6 to \$8 and kept pace with
18 inflation, I have not shown on line "B", the 194,000 again
19 because the \$240,000, obviously, exceeds it, but when you get
20 down to the surcharge, again, we use the industry average
21 surcharge of .2152 which adds .0033 to the royalty rate
22 schedule for a total of .01853 and applying that royalty rate
23 to the \$240,000, you get 4447 compared to the 4117.

24 COMMISSIONER GARCIA: On example one and two, you
25 multiply it by 1.2152.

THE WITNESS: Which is the industry average, yes.

26 COMMISSIONER GARCIA: We wouldn't multiply that by
27 1.15 and bring in--

28 THE WITNESS: No. If you recall on Exhibit 14,

1 1.1515 is the cable rate increase.

2 BY MR. ATTAWAY:

3 Q You would multiply by .15.

4 A It is the case increase we are talking about. I
5 withdraw everything I said on this. We have to recalculate
6 it.

7 COMMISSIONER GARCIA: If calculated, it becomes
8 184. The theory would be the same.

9 THE WITNESS: Right. It would not affect it because
10 they still exceed the limits. On the other two sheets, it
11 doesn't apply because they are over.

12 CHAIRMAN BURG: Mr. Korn, yesterday, Mr. Attaway
13 made a representation of a 20 percent surcharge. I asked
14 Mr. Valenti about that 20 percent surcharge. He said he was
15 not the proper person to ask. Seeing that you are the last
16 witness, what happened to that 20 percent?

17 THE WITNESS: That's the .2152, 2152 percent industry
18 average surcharge.

19 CHAIRMAN BURG: But do you have to go through all
20 of this to accomplish that?

21 THE WITNESS: No, not on an industry average. It
22 is all done on Exhibit 14, the net surcharge. In other words,
23 the inflation minus the cable rate increase adjusted for 1980
24 base instead of '76 base gives you 21 percent. That I be-
25 lieve is what he was referring to.

CHAIRMAN BURG: Instead of 20. I understand.

THE WITNESS: If you want to do it that way, every-
body pay 21 percent more or whatever it would be when you
look at it again. This is based on April, 1980.

1 CHAIRMAN BURG: Which would do away with the neces-
2 sity of all of this, all of these computations.

3 THE WITNESS: These computations are made by each
4 cable system, just one of them not all of them. We showed
5 you samples of each one to show that it comes out to the
6 answer which is consistent with the Act holding the royalty
7 fee per subscriber constant.

8 The cable system would have to fill out the infor-
9 mation on here, not necessarily on this form but on a revised
10 form three.

11 CHAIRMAN BURG: Okay.

12 COMMISSIONER GARCIA: I am confused on one issue
13 still. The revenues from the tiers, the examples that you
14 gave us cable by cable would cover those.

15 THE WITNESS: I didn't hear the first part.

16 COMMISSIONER GARCIA: The tiers.

17 THE WITNESS: The tiering problem is, first, that
18 revenues may be reduced. One of these shows revenues reduced.

19 The other tiering problem is that a new system
20 may come on with zero or free service in the basic service
21 chart.

22 COMMISSIONER GARCIA: I guess, Mr. Korn, my ques-
23 tion is only if we do it system by system will we be able to
24 take care of the tier. If we do, one, adjust, let us say,
25 what your recommended 20 percent for the whole cable industry,
we still have lost the tiers that are now falling through the
crack.

THE WITNESS: Yes. I am not recommending the 20
percent across the board.

1 COMMISSIONER GARCIA: I understand that.

2 THE WITNESS: Not only are the tiers lost but some
3 of the other factors we mentioned are lost. How do you treat
4 systems that went up higher than inflation?

5 How do you treat systems that didn't go up at all
6 or went down and therefore are getting the benefit of a low
7 base to apply to percentage against the expense of the other
8 systems because they are not average.

9 BY MR. ATTAWAY:

10 Q Mr. Korn, counsel for NCTA was concerned about the
11 effect of your proposal on systems that came in to being since
12 1976 and how the small system ceiling would be applied to
13 them.

14 As I understand your proposal, for a system in
15 being in 1976, you would take their actual '76 rate and com-
16 pare it to the actual 1980 rate and multiply the ceiling number,
17 the 80 and the 160 times the percentage increase in the cable
18 systems' individual rates over that period of time.

19 A That's correct.

20 Q If the system was charging the industry average in
21 1976 of \$6.60 or whatever it might be and increased it to \$8
22 which would be a 21.2 percent increase, the ceiling, small
23 systems' ceiling, for that system would be increased by 21.2
24 percent.

25 A I don't know if-- I think it is a 33 percent in-
crease.

Q I am not very good with the calculator but the
same percentage.

A Whatever that increase would be, it would increase

1 the ceiling to that.

2 Q Take a system that did not exist in '76 and you have
3 assigned a constructed '76 subscriber rate to them; right?

4 A Yes.

5 Q Which would be the industry average in '76? If the
6 industry average was \$6.60 in '76 and the new system that just
7 came into being this year is charging \$8, you would again
8 multiply the small system by that percentage of increase.

9 A That's correct. In other words, the new system
10 would be treated exactly the same as the old system except we
11 have a proxy 1976 base rate which would be the industry
12 average.

13 Before when I said I did not address that problem,
14 I guess I really forgot how to handle it. The form does
15 address it by using a substitute value for '76 for a new
16 system which is the average industry value.

17 So, no matter what it is at present, you measure
18 from the average industry base and that increase is then
19 applied to the \$160,000 or revenue.

20 Q Counsel for NCTA was also concerned about the fact
21 that the statute applies the same royalty rates of .675 and
22 .425, et cetera, to all systems regardless of their particular
23 basic subscriber rate structure. I stipulate that that was
24 the case. It does not take that into account.

25 Under your formula, differences in the charge for
basic subscribers would be taken into account; is that correct?

A Yes.

Q Isn't that indeed the very purpose of this proceed-
ing according to the statute to take those changes into account?

1 A As well as the inflation change, yes.

2 Q Finally, counsel for NCTA was concerned about the
3 imposition of past inflation upon new systems. I wasn't
4 born yesterday but had I been, would not the past inflation
5 affect the prices I pay for goods and services today?

6 A Yes.

7 Q It would for new cable systems as well; right?

8 A Yes, I think the statute applies to new cable systems.
9 They want to keep the fees constant with the '76 dollar.

10 MR. ATTAWAY: Thank you.

11 MR. FELDSTEIN: Madam Chairman, can these worksheets
12 which Mr. Attaway and Mr. Korn have passed out, I wonder if
13 they could be marked for some kind of exhibit number if they
14 are referred to at some point?

15 MR. ATTAWAY: It would make it Exhibit 18. Let the
16 record show, however, that there is a error in the calculations
17 for the small system ceiling.

18 THE WITNESS: I can tell you what it should be.
19 Instead of 1.2152 on line "B"--

20 CHAIRMAN BURG: [interposing] Which page?

21 THE WITNESS: On the first sheet, line "B", instead
22 of 1.215, the correct figure should be 1.1515 and instead of
23 the result being \$194,000, the correct result is \$184,240.
24 The same two corrections apply to the next sheet. That's it.

25 BY MR. ATTAWAY:

Q Wouldn't you have to correct also the \$180,000?

A Yes. I would have to correct the \$180,000 figure.
Instead of 1.2152 there, it again should be 1.1515 and the
97216 becomes 92120 and the 486 becomes 461.

1 CHAIRMAN BURG: Mr. Attaway, could Mr. Korn submit
2 some clean copies?

3 MR. ATTAWAY: Yes.

4 CHAIRMAN BURG: That would be saving time now.

5 MR. FELDSTEIN: Marked as Exhibit 18?

6 CHAIRMAN BURG: Correct.

7 MR. ATTAWAY: Mr. Feldstein asked that some material
8 be inserted into the record. I have that now to introduce it
9 or I can wait until later. It is the Warburg Paribas Becker
10 Report and the Variety Analysis of Prime Time Production Cost.
11 This will become Exhibit 19 and 20.

12 [Whereupon, the document referred to were marked for
13 identification and received in evidence as
14 Exhibit Nos. 18, 19 and 20, respectively.]

15 COMMISSIONER GARCIA: Which is 19 and which is 20?

16 MR. ATTAWAY: The Warburg Paribas Becker will be-
17 come 19 and the Variety 20.

18 Madam Chairman, that concludes the direct case of
19 Copyright owners. I had intended to make a closing statement,
20 however, in light of the fact that our case has taken more
21 time than we advised the Tribunal it would take, as well as
22 opposing counsel, I think that the points that we have made
23 are clear to the Tribunal. I hope they are. I will close
24 without further argument.

25 CHAIRMAN BURG: Thank you. Mr. Garrett.

MR. GARRETT: Madam Chairman, for the record, my
name is Bob Garrett of the law firm Arnold and Porter here
representing major league baseball specifically but I believe
I speak for other professional sports leagues that are party

1 to this proceeding.

2 We have agreed with the other Copyright owners that
3 the interest of the expedited and orderly presentation of
4 brief, it would be in the best interest to allow Mr. Attaway
5 and MPAA to take a lead in the case which he has done very
6 ably. We have not sought, therefore, to introduce our own
7 witnesses nor introduce other own testimony.

8 Nevertheless, I want to make it clear we have worked
9 closely with MPAA in its prosecution of the case and we
10 strongly support all the proposals of the Copyright Owners.

11 I would like to emphasize one aspect of the owners
12 if I could. The NCTA and the cable industry has suggested
13 that the Tribunal should adjust the rates essentially on a
14 catch up basis.

15 Specifically that if they adjust them at all, if
16 the Tribunal adjust the rates at all, it should be on one
17 time and not changing again until 1985.

18 The Copyright Owners, on the other hand, have urged
19 that the Tribunal adjust the rates so the cable system for
20 each semi-annual accounting period pays a royalty which re-
21 flects the change in inflation as well as that system's
22 change in rates.

23 As Mr. Korn has testified, the difference between
24 the two proposals is considerable. The amount of royalties
25 that we stand to lose over the next five years when one
26 plays the catch up adjustment games that NCTA suggests would
27 be in the neighborhood of several million dollars.

28 I would like to just answer, if I could, also,
29 Madam Chairman, a question you raised earlier. I don't believe

1 that the proposal that the Copyright Owners have submitted
2 here would result or obviate the need for a review in 1985.
3 I think that the record will very clearly demonstrate, for
4 example, that there is to be no changes in their rate adjusted
5 here as a result of any kind of effect that the franchise
6 authorities would have on raising rates.

7 I believe, however, that in 1985 the cable industry
8 can come in and say there has been an effect and that is a
9 factor you can taken into account as to a change in future
10 years. There is still plenty of work that can be done in 1985.
11 I don't believe that the record before you here that there
12 would be a need for that kind of adjustment. I guess with
13 that, unless there are any questions, the balance of my 12
14 percent of my time will be spent here.

15 CHAIRMAN BURG: Thank you.

16 Questions. If not, we will proceed to your direct
17 case Mr. Feldstein.

18 MR. FELDSTEIN: Thank you.

19 My apology to the rear of the room for not being
20 able to see these charts as they are presented.

21 I would like these marked as NCTA exhibits. Notice
22 there is 3-A and 3-B. It runs essentially 1 through 12. They
23 are marked as such not on these charts but on the soft copies.
24 You will notice that you do not have number 13. That one will
25 be handed out later. This runs through 12. The list on the
front is not an exhibit. It is merely a table of contents
for reference.

The provisions under which we are working are

1 Section 801(B)2A and D of the Copyright Act. As has been
2 pointed out to you in previous testimony, the goal is to main-
3 tain the real constant dollar level of the royalty fee per
4 subscriber as of the date of enactment of this Act.

5 The statute states that this Tribunal authority is
6 to make determinations concerning the adjustment of the Copy-
7 right Royalty rates in Section 111 solely in accordance with
8 the following provisions.

9 It is also made clear in the House report on page
10 175 where it again tracks the language and states solely in
11 accordance with the following provisions.

12 The following provisions in Section 801 and subse-
13 quent sections states that an adjustment of the royalty rates
14 found in Section 111 shall be made every five years. Likewise,
15 an adjustment of the gross receipts limitation for smaller
16 systems shall be made every five years.

17 This is reiterated in the Conference Report where
18 it states that the copyright, at page 76, excuse me, it states
19 that the Copyright Royalty, then called commission, would
20 review the rates established in the bill in 1980 and at five
21 year intervals thereafter. Explicit limitations were placed
22 on the factors the Commission could consider in making its
23 periodic rate revisions.

24 Thus, it is our interpretation not our interpreta-
25 tion we believe that the statute quite clearly states that
the royalty rates shall be adjusted, that this adjustment
shall be every five years, not that a mechanism shall be placed
into effect which will automatically adjust the rates every
six months. Congress could have done that. This is what

1 Congress did.

2 Secondly, the 1976 scheme applies to royalty rates
3 as well as the gross receipts limitations on an average basis
4 over the entire industry. Each system uses the same rates.
5 Each system uses the same gross receipts limitations. The
6 statute is based on averages. It is like the income tax code
7 or any other of a number of statutes. It does not permit, it
8 is not without the four walls of this statute, it is not solely
9 in accordance with this statute to make adjustments on an
10 individualized system basis. Thus, in the case of DES systems
having 1,050 different royalty rates.

11 Thus, the issues between us and the copyright owners
12 are clear. An adjustment every five years pursuant to statute
13 or a mechanism for adjustments every six months. An adjust-
14 ment to the industry as a whole as provided in the 1976
15 statute or an adjustment based on an individualized system
basis.

16 Now, moving on, the language of the statute, again,
17 to repeat this states that what is to be maintained is the
18 real constant dollar level of the royalty fee per subscriber.
19 That does not say per program. It does not say per signal.
20 It states royalty fee per subscriber. How many dollars were
21 obtained per subscriber as of the date of enactment of this
Act, October 19, 1976?

22 How many dollars are obtained from a subscriber now
23 and has that increase, if there has been an increase, kept up
24 with inflation considering all of the other factors which
might come into play?

25 There is also explained at page 175 of the House

1 the rise in the royalty fee per subscriber and inflation,
2 we will also demonstrate that regulatory restraint is real
3 and has pervaded a substantial portion of this industry and
4 has had both a restraining effect on the amount of rate in-
5 creases as well as a considerable delay in obtaining rate in-
6 creases of whatever size, and that the Tribunal should take
7 into account the substantial regulatory restraint in making
8 its final decisions as the Act provides.

9 ~~As for the smaller system adjustment~~ which calls
10 for the gross receipts limitations to be adjusted rather than
11 the rates the copyright is figured on, this states it shall
12 be adjusted to reflect national monetary inflation or defla-
13 tion or changes in the average rates charged cable system
14 subscribers for the basic service in order to maintain the
15 real constant dollar value of the exemption provided by such
16 section.

17 The operative words to maintain the real constant
18 dollar value of the exemption. It is our contention that if
19 inflation exceeds the rate increases which these systems
20 were able to obtain between 1976 and 1980, then the dollar
21 limitation must be adjusted to the limits of inflation.

22 Both of these considerations, again, are for the
23 industry as a whole which we believe is what the Act specifi-
24 cally provides for.

25 I would like to call my first witness.

CHAIRMAN BURG: All right.

MR. FELDSTEIN: Robert Crandall.

Whereupon,

nlw-19

ROBERT CRANDALL,

was called as a witness, and having been duly sworn, was examined and testified as follows:

MR. FELDSTEIN: Before Mr. Crandall, begins his testimony, let me alert the Tribunal and Mr. Attaway that Mr. Crandall has an important previously made engagement which he must meet at 4:00 o'clock. If we are finished with him in terms of direct and cross, fine, but I would ask your indulgence if there is a conflict until tomorrow with Mr. Crandall to accommodate him.

CHAIRMAN BURG: All right.

DIRECT EXAMINATION

BY MR. FELDSTEIN:

Q Would you please state your name and occupation?

A My name is Robert Crandall. I'm an economist, senior fellow at the Brookings Institute.

My background and qualifications are that I have a Ph.D in Economics from Northwestern University. I have taught for eight years on the economics faculty at the Massachusetts Institute of Technology. Since that time, 1974, I spent one year as advisor to Glen Robertson, Commissioner in the Federal Communications Commission and two and one half years in the Council of Price and Wage Stability as assistant director, acting director and deputy director leaving in January of 1978 to assume my present position.

Q Mr. Crandall, you see we have put up a chart which you will find in your soft list there as Exhibit 2. Can you explain the chart to the Tribunal?

A This is a chart prepared under my direction of the

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1 alternative measures of inflation. Since this proceeding deals
2 with attempts to maintain the real constant dollar value of
3 some flow of income, the question arises as to which is the
4 appropriate deflator to deflat nominal dollar flows so as to
5 render them comparable over a period of time of general infla-
6 tion.

7 The measures are here are but a few of those avail-
8 able. The problem of determining the ideal index number is
9 a problem that has been with us for a very long time, in fact,
10 eludes a satisfactory solution. There is no ideal index.
11 Some are better than others.

12 The most commonly used general index is the consumer
13 price index which is the CPIU. This is introduced monthly by
14 the Bureau of Labor Statistics.

15 The column next to it on the right is the consumer
16 price index less mortgage interest rates to show how much
17 since October, '76, mortgage interest rates have contributed
18 to the increase in the consumer price index.

19 To the left of the consumer price index-- By the
20 way, both of these the CPIU and its subcomponents, the mort-
21 gage interest rates, are not seasonally adjusted. One could
22 often include the seasonally adjusted numbers. For most pur-
23 poses, the seasonally adjusted number is probably a better
24 choice.

25 The problem when you get into mortgage interest
rate is that the interest rates usually have not followed any
any well-worn seasonal track. We have had two very serious
credit crunches announced by the Federal Reserve not at all
related to seasons; one was in October of last year and one

21

1 in March of this year.

2 The remaining columns on this chart are deflators
3 used by the Office of Business Economics, now called the
4 Bureau of Economics Analysis, at the Department of Commerce
5 to deflate various components of our gross national product
6 in order to make comparisons over a period of time of the
7 value of GNP and the subcomponents.

8 The most general one is the GNP deflator in the far
9 right. That is supposed to deflate everything in the gross
10 national product including the government for which there is
11 no good deflator. The only thing you can have in there is a
12 measurer of the progress of wages and salaries in the govern-
13 ment sector since there is no measurement of government out-
14 put for example.

15 In subcategory, Private Product Business Deflator,
16 includes all the private business in the United States. It
17 excludes government but other than that, it has all the rest
18 of the economy. You see its progress has been virtually
19 identical to GNP.

20 The far left is the PCE deflator which is the
21 Personal Consumption expenditures deflator which the Bureau of
22 Economic Analysis usually deflates annual flows of consumption
23 expenditures for all consumers. You will note that that index
24 has moved less rapidly than the consumer price index over a
25 period of time.

By the way, that estimate of October to March for
that index is an estimate based upon an interpolation between
the third and fourth quarters of 1976. It was back in 1976,
they did not publish a monthly index. They now publish it

1 monthly. So, I simply interpolated it linearly between
2 those two quarters to get an estimated value for October.

3 The rate of increase in these two is smaller than
4 the rate of increase in the PCE deflator since these are
5 quarters rather than October to March. So, they are somewhat
6 smaller because they are obviously centered in December and
7 February rather than October and March.

8 Of these measurers, the question arises what would
9 be the best choice of an index. It all depends on what you
10 think you are deflating. If you interpret the fact sheet to
11 mean you are deflating the flows of payments to individuals
12 to consumers, you want a consumption index.

13 If the real constant value of copyright payments
14 to a variety of owners of copyright rights are to be seen
15 as payments to those individuals for their own private con-
16 sumption, clearly you want consumption. Then the question
17 arises which consumption measurer.

18 Over a very long period of time, it wouldn't make
19 a lot of difference. If you were to go back 30 or 40 years,
20 and we were during this over a very long period of time, the
21 PCE and CPI have tended to move pretty much the same way. The
22 reason is that the PCE is comprised of individual categories
23 drawn from the CPI enumeration of the price of individual
24 indexes.

25 However, in recent years, they have begun to divert
because of the ways the CPI is measured and specifically
because of the housing components. The housing component
in the CPI can be described but its basis cannot be under-
stood by anyone. It is simply an arbitrary calculation. The

1 calculation, perhaps, which has been explained before but
2 I can go over it briefly. It is simply a measure which takes
3 the home purchase price for all new houses purchased subject
4 to FHA guaranteed loans, and, therefore, the lower segment of
5 the houses purchased and adds to it one half of all of the
6 future financing costs implicit in the mortgage agreement, so
7 that if an individual, for instance, commits himself to buying
8 a \$70,000 and to paying over a 30-year period, something like
9 \$250,000 worth of interest payments, \$125,000 of those will
10 be added to the 70 and that becomes the basis for the housing
11 index.

12 In fact, if the consumer price index were the cost
13 of living index, that, of course, would suggest that there is
14 a tremendous error in measuring the cost of living for most
15 consumers. That isn't even a very good way to measure the
16 cost of living for those people who buy FHA guaranteed
17 houses.

18 Certainly it is not a way of measuring what has
19 happened to the cost of living for other people particularly
20 those people who have more mortgage than those who purchased
21 their houses in previous years.

22 You can see a divergence here between the CPI and
23 the CPI less mortgage interest rates which was peaking about
24 April or May of this year because the credit crunch hit in
25 March. The mortgage interest rates began turning in April
or May. In fact, the peak in the index was probably not
March or April but 60 days after that since it only enters the
index after closing, not at the time of initiation of the
mortgage agreement. You have a mean lag which varies depending

1 upon the cycle but say about 60 days.

2 So, we had an artificial increase due to the mortgage
3 interest rate component as interest rates were soaring through,
4 perhaps, June or July of this year. Since then, we have had
5 a sharp decline in this part of the CPI. That, as a matter
6 of fact, the index for the month of July showed, I believe,
7 a zero increase because of the sharp decline in mortgage in-
8 crease rates, according to the housing industry, offset the
9 other inflationary increases in the economy. That effect con-
10 tinued in August. It will continue in a very minor way in
September and will be back on the upward track again.

11 What this means is if you terminate any calculation
12 of the cost of living in March or April of this year, you
13 have an artificial bias introduced by the way in which the
CPI is constructed.

14 Now, there are other problems with the deflators
15 but that is the biggest single problem. The Bureau of Labor
16 Statistics understands the problem. As a matter of fact, Jean-
17 nette Norwood served with me on a committee under the Ford
18 Administration to deal with that problem. We finally sometime
19 in '76 threw up our hands for a variety of technical and
political reasons and decided not to do anything about it.

20 Since that time, the Bureau of Labor Statistics
21 has begun to publish alternative indexes of home ownership
22 costs but has not made a decision to incorporate any of them
23 into the CPI.

24 The other problems with the CPI and therefore
25 carried over into the PCE deflator are that they overstate
inflation because of a failure to address a changing and

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1 improving quality of consumer goods. This can be a very
2 important upward bias as shown by a recent study by Robert
3 Gordon of Northwestern University in a study for the National
4 Bureau of Economic Research.

5 The other major difference between the CPI and
6 PCE deflator is that the CPI is a fixed weight deflator. This
7 means that regardless of the change in relative prices,
8 consumers are assumed to keep the same consumption bundle
9 over time until periodically, every ten years or so, the
10 fix rates are adjusted. The most recent adjustment was in
11 the early 1970s; 1972-1973.

12 The PCE deflator as it appears on this board is
13 the so-called implicit PCE deflator which has current period
14 weight. There is also produced by the Bureau of Economic
15 Analysis a fixed rate deflator if you wish to use that one.

16 It is well known among economists that a fixed
17 rate deflator overstates inflation and a current weight de-
18 flator understates it. There is no ideal measure between
19 the two of them. It would be something in between, but that
20 source of bias is relatively small one, probably amounting,
21 over the period in question, less than half a percentage
22 point per year.

23 Whereas, the treatment of home ownership is much
24 much larger. It would seem by far the better deflator to use
25 for deflating consumption is the PCE deflator. Indeed the
decision which has been made a long time ago by the Bureau
of Economic Analysis at the Department of Commerce, and while
it is not an ideal deflator and while it still has some

1 problems because of the difficulty in treating weights and
2 the difficulty in treating product quality, its housing com-
3 ponent is probably a better component in that it attempts to
4 expedite--

5 CHAIRMAN BURG: Mr. Crandall, would you slow your
6 pace down please.

7 THE WITNESS: Yes. It attempts to estimate the
8 inflicted rental cost of owning a house and uses status quos
9 for all houses rather than simply focusing on new houses. So,
10 I would suggest to you that the PCE deflator is by far the
11 better deflator for the budget consumption expenditures over
12 time particularly any time period in the early 1980s.

13 BY MR. FELDSTEIN:

14 Q Mr. Crandall, what you are therefore saying to this
15 Tribunal is attempting to utilize the most accurate publicly
16 available measurer of inflation, if we use a national consum-
17 ption index that the CPI's deficiencies are such that the
18 PCE would be a more accurate and better measurer?

19 A Yes.

20 Q There have been--let me clarify some of these points
21 by stating some of the, repeating back to you some of the,
22 things that were stated in favor of the CPI and against the
23 PCE by Mr. Korn yesterday.

24 Mr. Korn said that the CPI was better because it
25 includes only urban consumers whereas the PCE is not better
because it also includes rural consumers.

A I suppose if copyright owners are supposed to live
only in urban areas, there might be some validity to that but
I would presume that you would want a national measurer. If

1 you want a national measurer for all consumptions the PCE
2 would be the better choice.

3 Q Mr. Korn stated that the PCE had a fault because it
4 includes non-profit institutions. Would you comment on that?

5 A The PCE has nothing to do with profit or non-profit.
6 The PCE is a measurer of the cost of a changing bundle of
7 consumer expenditures. Some of these consumers may work for
8 non-profit institutions but we don't use them out of the
universe of consumers for that reason.

9 Q In comparing the CPI with the PCE, Mr. Korn said that
10 because you had a fixed market basket in the CPI, it would
11 measure only price changes. Whereas the in the PCE, the market
12 basket changes with prices, so you could not tell whether the
13 index was changing because of the price or because of the
market basket.

14 A Well, I addressed that point earlier. Basically,
15 the idea of an inflation index ought to be to try to attempt
16 to measure the percentage by which a person's nominal income
17 must increase to keep him at a constant level of satisfaction,
18 if you will.

19 It would be silly, obviously, to use fixed weights
20 if, for instance, tomorrow because of difficulties in the
21 Middle East the price of gasoline went up to \$250 a gallon.
22 Few of us would maintain our consumption habits as they now
23 exist if that were to occur. In fact, people would find
24 themselves just as well off with some increase in income less
25 than that connoted by the requirement that they spent income
on 20 gallons of gasoline a week at \$250 a gallon. They would
substitute something for that and would be just as well off

1 with a smaller increase in their nominal income.

2 The problem is that a flexible weight or current
3 weight deflator as the PCE deflator probably understates in-
4 flation slightly. The fixed weight deflator overstates it.
5 The difference between the period in question is relatively
6 small for the PCE. We could put up the PCE fixed delator
7 and you would see that it is not that much difference from
8 the PCE current weight deflator.

8 The fact is there is no ideal index number.

9 Q You have told us quite clearly, I think, how in-
10 flation in the CPI has been over measured because of the
11 interest rate and home ownership costs. The PCE deflator
12 uses rentals to measure prices for home ownership. This use
13 has been criticized by Mr. Korn. Would you comment on that
14 and compare it with the measure of home ownership used in
15 CPI?

16 A I can't comment on his criticism because I didn't
17 hear it. There is a problem of using rental prices; that is,
18 that because of our tax laws and the advantage of home owner-
19 ship, under the tax laws because of the deductibility of
20 mortgage increase payments.

21 The market for rental housing, particularly in the
22 higher housing value category, is rather thin. That is one
23 reason why the Bureau of Labor Statistics has traditionally
24 been reluctant to go to a rental price measurer because of the
25 difficulty of getting a robust enough sample.

A second difficulty arises because there is a problem
in defining what is a cost of holding a house to you. In
fact, you are realizing capital gains at the time. Perhaps,

1 you want a much more elaborate user cost index which would
2 take into account those capital gains during an inflationary
3 period. In fact, rental prices do take those into account if
4 imperfectly. It is not an absolutely perfect measurer but
5 I am not sure that one can find a perfect measurer. It is
6 certainly better than the arbitrary component in the CPI
7 right now.

8 Q Now, Mr. Crandall, moving on to another comment that
9 was made yesterday by Mr. Korn, although he recommended the
10 use of the CPI, he entered into evidence a chart which showed
11 that between 1975 and 1978, the expenses for syndicated tele-
12 vision programs as reflected in some FCC data increased during
13 that three-year period some 44 percent. Do you have a copy
14 of this?

15 A No, I don't have it before me.

16 Q This was CO Exhibit 11.

17 Are you familiar with this data and how it is
18 compiled?

19 A Yes, I am.

20 Q Can you speak to the matter of the accuracy and
21 reliability of this figure?

22 A In the first place, if these numbers were measured
23 correctly, this does not reflect a change in the price of
24 syndicated programming per hour of programming or per hour
25 of programming standardized for viewer appeal. That is
a measurer of total flows of payments from station to pro-
gram owners as reported to the Federal Communications Com-
mission. If in fact there is more being bought over time,
the FCC in its wisdom suggested that we should not get network

1 programming for more than three hours at night and should get
2 game shows from 7:30 to 8:00 o'clock, then we are going to
3 get an increase in the total amounts of syndicated programming.

4 That generates a greater increase than the price
5 of the program. This does not come from an uniform system of
6 accounts. It is not exactly clear what station owners are
7 reporting when they report. It is a bad series as reflected
8 in a report by the Rand Corporation for FCC and completed
about 1975-76.

9 They concluded they could not use any of the data
10 from the form 3324 reported by stations to FCC because on
11 serious analysis, they did not make sense. They were initially
incorrect and generated non-sensible results.

12 It is not clear. For instance, in this case, it is
13 not clear that people are reporting outlays for programming
14 to be exhibited in a single year. They may be reporting out-
15 lays for three years, four years, five years in advance. You do
16 not know what they are reporting.

17 MR. FELDSTEIN: That concludes my examination of
18 this witness.

19 CHAIRMAN BURG: I have one question, Mr. Crandall.

20 Yesterday Mr. Korn gave us some examples of segments
21 of society that used the CPI. Can you give us some examples
of what businesses use or have used the PCE?

22 THE WITNESS: The only use of it, at the present
23 time, that I know as a routine matter is the Bureau of Economic
24 Analysis for deflating social accounts.

25 However, more and more in policy levels, both private
and public people are not using the unabashed CPI index

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1 noticing that it is so biased because of the way it treats
2 mortgage interest cost. Internally, either with this and this
3 administration for which both I worked, we would not use the
4 CPI as what is really happening in inflation. It is merely
5 ingrained in contractual arrangements and is difficult to
6 change. Everybody understands it is not a good measurer of
the changing in the cost of living.

7 CHAIRMAN BURG: Understanding that they have not
8 necessarily gone over to the PCE.

9 THE WITNESS: Yes. You can understand that there
10 are serious political problems for so doing. If a contract
11 has been assigned in which things are to be indexed under
12 CPI and in an inflationary situation, those people who are
13 signatory are not likely to go to more accurate forms of
14 looking at inflation if it is going to change their standard
of living.

15 That is from the organized labor which is an im-
16 portant index for this. They would probably have to continue
17 to publish the old index for some time because grandfathers
were struck because of that contract if it were changed.

18 COMMISSIONER JAMES: You indicated a lot of busi-
19 nesses are using this now as part of their consideration. Is
20 there any documentation that you can provide us that shows
21 the use of the PCE?

22 THE WITNESS: I cannot at this time. I can suggest
23 to you in the business press now there is wide spread recogni-
24 tion of the fact that CPI does not measure inflation. You
would not predict interest rates on the basis of CPI.

25 COMMISSIONER JAMES: Say that again.

1 THE WITNESS: There are people who attempt to
2 predict the interest rates by predicting inflation. You
3 certainly would not use the unadulterated CPI to do that.

4 COMMISSIONER JAMES: You are saying they use as a
5 part of their predictions the PCE.

6 THE WITNESS: No. I am saying they understand and
7 adjust for the fact that CPE overstates inflation. I have
8 no evidence to bring to you the fact that people are now
9 using PCE.

10 CHAIRMAN BURG: I want to give the reporter a
11 break. Let's take a five minute recess please.

12 [A short recess was taken.]
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1 CHAIRMAN BURG: Back on the record.

2 CROSS EXAMINATION

3 BY MR. ATTAWAY:

4 Q Mr. Crandall, you have covered almost the identical
5 same ground as Mr. Korn did yesterday and came to a very
6 opposite conclusion. I guess the only thing we can derive from
7 that is that reasonable men can differ on these issues.

8 A Most of the things to which I testified ninety-nine
9 point nine percent of the profession is in agreement with me
10 about this various basis in the CPI.

11 Q Which was admitted by Mr. Korn. He would agree with
12 you. You started out by saying there is no ideal index. Then
13 you went on by saying the most commonly used index is the CPI.
14 In response to questions from the Tribunal, you said insofar
15 as you knew no one other than the Commerce Department was using
16 the PCE as a deflator.

17 So, are you asking this Tribunal to, in effect, plow
18 new ground with respect to the choice of an appropriate inflation
19 index?

20 A I suggest that the problem is quite different now.
21 In fact, I pointed out these two indices track one another for
22 a very long period of time during period of low inflation in
23 this country.

24 The ad hoc choice for the housing component tended
25 to work out fairly well even though it had no sound and cyclical
basis. It is now inadequate for a period of rapidly rising

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1 inflation. We are on a path of much higher inflation rates than
2 the earlier '50s. I suggest to the panel they need not repeat
3 the mistakes of the past. The fact others have used the CPI
4 which is a flawed index, does not mean the mistake has to be
5 repeated here.

6 So far as you know if the Tribunal were to use
7 the PCE, it would be the first organization to do so other than
8 the Department of Commerce.

9 A Public organization for systematically deflating
10 income measures, yes. I think that is correct. Although the
11 Congressional budget office is engaged in a full fledged study
12 of this matter, it may turn out there are other organizations
13 using the PCE.

14 Q You stated in your opinion the PCE was the more
15 accurate and better measure. You made reference to work you
16 did with Janet Norwood.

17 You said that she decided not to make any changes.
18 Why, given the fact that PCE, your opinion, is a better deflator,
19 why weren't changes made?

20 A Janet Norwood was not the only member of the committee
21 chaired by Burton Malcult of the Economic Advisor. I don't
22 recall why we decided not to change the housing component. I
23 think it is sufficient to say there would be strong political
24 argument against doing it. Give the technical problems of making
25 the shift, they decided not to do it at this time. I suggest
the pressures are going to forw as long as inflation stays at

etp3

1 or near double digit. We cannot have the Bureau of Labor
2 statistics putting out such an obviously flawed series.

3 Q That, nevertheless, is the series they are putting
4 out today?

5 A Yes. With numerous apologies. Which would show you
6 now this index would be if they did it slightly better.

7 Q Are any of these indices, particularly the CPI, the
8 number listed there an average for the month or does it relate to
9 a specific date in the month?

10 A They are for the entire month or quarter. As a
11 matter of fact because of the bureaucratic organizational
12 problems of obtaining observations on so many prices, some are
13 systematically collected earlier in the month, some in the
14 middle and the latter parts of the month.

15 Some of the more sophisticated forecaster of the CPI
16 know when the things occur and are able to know what they are
17 going to report. They are reported for the entire month.

18 I suppose you could say they are centered in the
19 middle of the month.

20 Q If you are measuring the rate of increase in CPI
21 between October of 1976 and April of 1980, you would use October
22 of '76 and April of 1980 rather than March of 1980?

23 A Yes. If you wanted to measure through April.

24 Q Why is it that you only measured through March?

25 A Counsel for the Cable Association wanted to do it.
through March. I have no particular preference for any period.

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1 MR. ATTAWAY: That is all the questions I have.

2 REDIRECT EXAMINATION

3 BY MR. FELDSTEIN:

4 Q On that one, that question that Mr. Attaway just
5 asked you, he asked you, I believe, what CPI figures, months
6 CPI figure you would use, Mr. Crandall if you were trying to
7 measure inflation through April. If you were trying to measure
8 inflation through March, that is to say until April 1, 1980,
9 would it be appropriate to move on and use the CPI for April?

10 A I guess if the magic date is April 1, I would
11 want an average between the March and April figures since they
12 both are for to the entire month. April 1, comes conveniently
13 at the end of March and the beginning of April.

14 Q Mr. Crandall, you have stated that the CPI has
15 become embedded with all of its inaccuracies in labor contracts
16 in Social Security; is that correct?

17 A Yes. Not in all contracts.

18 Q The difficulty of changing what is known to be an
19 inaccurate measure is caused by the vested interest involved in
20 those unions?

21 A Sure.

22 Q In your judgment if a body such as this Tribunal in
23 a proceeding on a first time basis, would they be well advised
24 to avoid these errors by using a more accurate measure?

25 A Certainly. I think they ought to use the most accu-
rate measure they can find for the magnitude in question.

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1 COMMISSIONER JAMES: Again, going back to the
2 question the Chairman asked you, you eventually see that the CPI
3 when the political ramifications have been straightened out
4 will become the prevailing deflator?

5 THE WITNESS: Not quite. We will stay with the
6 figured weight rather than the current where they change each
7 month. We will change housing. The PCE use a rental equivalent
8 for monthly cost of owning a home, what it would cost to rent the
9 house.

10 I am not sure it would go that direction. It is
11 a simple way to go the alternatives spelled out from the Bureau
12 of Labor Statistics. They will go in the direction on PCE on
13 the housing component.

14 Q When do you think this would probably take place, the
15 next two three or four years?

16 A I would condition my estimate on how bad inflation
17 got. This divergence is going to grow with increasing inflation
18 and rising mortgage interests rates. If, in fact, we find
19 ourselves on an increasing tract of inflation with mortgage
20 interests rates going up to 15 to 20 percent, I would think
21 the pressures would grow.

22 I can't predict when they would be sufficiently
23 strong to offset pressures from the other side.

24 Q You agree with Chairman at such time when a gradual
25 converse was made probably any contracts or the Social Security
would probably be grandfathered in in some fashion or they would

etp6

1 publish both with an adjustment on the CPI; is that my
2 understanding?

3 THE WITNESS: I am not a lawyer or expert on
4 contracts. I would imagine there would have to be accommodations
5 for the change. What is safely predictable is the whole CPI
6 would continue to be published for several years after.

7 COMMISSIONER JAMES: Is it possible we could adopt
8 a CPI with a provision in the vent the whole country as a whole
9 converted to PCE, the factor would be considered at that time?

10 THE WITNESS: You could do that but it seems to me
11 that is simply adopting everyone else's error until they make
12 a change. I don't see why you have to be locked into making
13 the same error they do.

14 COMMISSIONER JAMES: It's called we should bite the
15 bullet.

16 Thank you.

17 CHAIRMAN BURG: Thank you, Mr. Crandall.

18 (Witness excused.)

19 MR. FELDSTEIN: Charlotte Beales.

20 MR. ATTAWAY: Madam Chairman, Mr. Korn now has
21 those Exhibits he promised at the convenience of the Tribunal
22 and Mr. Feldstein we can present them at anytime.

23 CHAIRMAN BURG: No explanations? ~~This is just handing~~
24 things to us.

25 MR. ATTAWAY: If opposing counsel would have the right
to cross examination to it and the Tribunal permits, I have no

1 objection.

etp7

2 MR. FELDSTEIN: You can just pass out the exhibits
3 asfar as we are concerned.

4 CHAIRMAN BURG: Do you want them now, Mr. Feldstein,
5 or later?

6 MR. FELDSTEIN: Certainly.

7 (NCTA's Exhibits 21 and 15 were marked for identifica-
8 tion and received in evidence.)

9 Whereupon,

10 CHARLOTTE BEALES

11 was called as a witness and, having been previously duly sworn,
12 was examined and testified as follows:

13 DIRECT EXAMINATION

14 BY MR. FELDSTEIN:

15 Q Mrs. Beales, may we have your name and your occupation?

16 A My name is Charlotte Beales. I am the Director of
17 Research for the National Cable Association.

18 Q Could you tell us some of your past professional
19 experience and your education?

20 A Prior to joining NCTA, I worked for WRC Television
21 which is a Washington, D.C. television station, owned and
22 operated by NBC. I was directing their activities in media
23 and research. Prior to that, I served as Director of Research
24 for WBBM-TV, a television station owned and operated by CBS,
25 located in Chicago. I hold a BA in Communications with a

etp8

1 concentration of communications research from George Washington
2 University.

3 Q As we have seen, the royalty fee per subscriber from
4 October '76 until this date, until the end date for this proceed-
5 ing is a measure which is critical to the decision which this
6 Tribunal must make. So, we must first determine the royalty fee
7 per subscriber in the words of the account as of the date of
8 enactment of the account which is October 1976. Have you been
9 able to discern this fact?

10 A Yes. I believe that fact is readily available in
11 the legislative history from the time of the Act. We have includ-
12 ed on the chart here information --

13 Q This is chart 3 in your soft charts?

14 A A copy from page 91 of the legislative history. At
15 that time as you can see, in the wording of the legislative
16 history based on current estimates supplied to the committee,
17 the total royalty fees paid under the initial schedule established
18 in the bill should approximate \$6.7 million. Compared with the
19 present number of cable television subscriber calculated at 10.8
20 million, copyright payments under the bill would, therefore,
21 approximate 81 cents per subscriber per year.

22 Q Eighty-one cents per subscriber per year was Congress'
23 estimate of the royalty fee per subscriber.

24 A That is my understanding since it is printed in the
25 legislative history.

etp9

1 Q Did Congress recognize that it was making a projec-
2 tion based on an estimate?

3 A That seems to be clear in the language. They include
4 would approximate 81 cents calculated on 10.8 million and so on.
5 It seems to be an estimate.

6 Q At the bottom of the chart, further beyond in the
7 report, was this not clarified further?

8 A Yes. I believe it was from page 175, the Committee
9 recognitions, however, that no royalty fee will be paid by
10 cable systems unless the legislation is effective on January 1,
11 1978, and accordingly, that that royalty fee per subscriber base
12 calculated at the time of enactment must necessarily constitute
13 an estimated value.

14 In the Committee's view and based on projections
15 supplied by the interested parties, the total royalty produced
16 under the fee schedule at the time of enactment should approximate
17 \$8.7 million.

18 Q For the sake of understanding as to how we proceed
19 beyond this, can you gratefully demonstrate how the House
20 Committee report arrived at the 81 cents?

21 COMMISSIONER JAMES: Before you get to that, can you
22 explain to me, based on current estimates supplied to the
23 Committee, supplied by who?

24 THE WITNESS: On 175, it said by interested parties.

25 COMMISSIONER JAMES: Who might that have been?

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THE WITNESS: I know NCTA, of course, recently joined them. NCTA developed some of the information. Some of the copyright holders, understand, also provided some of the information.

COMMISSIONER JAMES: The only reason I am asking this question is that you are calling attention to it. The person at that time who would be the best person to know would be the people you currently represent?

THE WITNESS: I would assume they would have been providing the estimates. The Television Fact Book is full of drawings and figures of calculations and that says 10.8 million. I believe a lot of the figures were publicly available.

MR. FELDSTEIN: In any event, the legislative history did rely on that as a royalty fee per subscriber as of the date of enact?

THE WITNESS: Yes.

BY MR. FELDSTEIN:

Q How was that calculated?

A It is relatively simple. You take copyright payments divided by cable subscriber yielding the royalty fee per subscriber. In the case of the information supplied in the legislative history, they said \$8.7 million would be collected.

At the time 10.8 million subscribers per year divided out to be 81 cents per subscriber per year. I may add all of the information I will be presenting will be on an analyzed basis.

etp11

1 basis. Much of the information you have heard before has been
2 on a semiannual basis. This is so there is no confusion in the
3 numbers. The legislative history was analyzed.

4 Q We are going to analyze to compare apples also
5 with apples also because the legislative history had it on an
6 analyzed basis?

7 A Exactly.

8 Q What you have here, the 81 cents is based on all
9 systems; is that correct?

10 A That is correct.

11 Q That means those systems who pay on a DSE basis as
12 well as those systems who pay on a smaller system dollar limita-
13 tion basis?

14 A That is correct.

15 Q I presume that the royalty fee per subscriber the
16 smaller systems is less?

17 A Yes. That is accurate.

18 Q In light of the fact that the adjustment preceding on
19 the royalty fee per subscriber is for DSE systems only and in
20 light of the fact the Tribunal in comparing the 1976 to 1980
21 will have a choice between using the figure for all systems and
22 the figure for just the systems who pay on a DSE basis, were you
23 able to break down for the 1976 date an approximation as to
24 what the royalty fee per subscriber would have been for DSE paying
25 systems at that time?

etpl2

1 A Yes. We have been able to make an estimate relying
2 upon publicly available information. You will find this is
3 Exhibit 3B in your soft copy. You will see the results of the
4 1976 royalty fee per subscriber breakdown on the chart.

5 The all systems data which we saw from the legisla-
6 tive history includes \$10.8 million subscriber, 8.7 million and
7 81 cents per subscriber figure.

8 The way we calculated information was to rely on
9 publicly available data. I will give you more detail on the
10 following chart. Basically, the small systems pay on a fixed
11 percentage basis or a flat rate we we are able to calculate
12 for the small systems how many they would be paying and subtracted
13 that information from the total to yield the information for the
14 DSE systems.

15 Q Now, could you please explain in a little bit more
16 detail the back up for arriving at those figures?

17 A The next chart which is labeled 3B has the breakdown
18 for the information for the small systems. We utilized two
19 sources in deriving these estimates.

20 The first was the results of the Copyright Tribunal
21 survey on the average rate charged back in '76 for the smaller
22 systems.

23 We found at the time we analyzed the questionnaires
24 in mid-July that the systems were gross receipts of less than
25 \$80,000 per year had an average basic subscriber fee of \$6.16 back in

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etp 13

1 October of '76 for those between \$80,000. per year and
2 \$320,006.64. The other source that we relied on in developing
3 this information is the 1976 Television Fact Book. That is
4 where the estimate of 10.8 million.

5 Q Subscribers?

6 A Yes. That Congress relied on.

7 CHAIRMAN BURG: Mr. Feldstein, I think you were
8 referring to 3C and you said 3B.

9 THE WITNESS: I am sorry. I did.

10 CHAIRMAN BURG: Mr. Attaway.

11 MR. ATTAWAY: Are you including that Congress relied
12 on the fact book in its estimate? If you are, I would like to
13 see some basis for that conclusion.

14 THE WITNESS: Perhaps, they did not rely on it. I know
15 the 10.8 million subscriber figure appears in the 1976
16 Fact Book. Perhaps, it is a coincident they estimated the same
17 amount. Since they used that, I believe, we could project out.

18 BY MR. FELDSTEIN:

19 Q The estimates that Congress relied on in passing
20 the Act in 1976, in your opinion, would they be based on the
21 data that was then available in 1976?

22 A I believe that would be the case.

23 Q The publicly available data on subscriber system
24 sizes and such data was commonly available in which source?

25 A The Television Fact Book has been relied on for

etpl4

1 information about our industry pretty consistently over the last
2 few years.

3 Q It should be pointed out to the Tribunal that this
4 breakdown we are doing in order to establish the royalty fee per
5 subscriber for large systems as opposed to all systems is our
6 estimate, not what Congress did. Congress had an estimate for
7 all systems which we will assert should be utilized by the
8 Tribunal.

9 This breakdown is only being done in the event the
10 Tribunal decides it wants to use the figures for only the DSE
11 paying systems.

12 Proceed, please.

13 A There is a chart available in the 1978 Fact Book en-
14 titled Systems by Subscriber Size. It will tell you how many sys-
15 tems have subscribers in the range of 500 to 1,000 subscribers
16 and so on.

17 We utilized this chart to get an estimate of the
18 number of systems who would fall in each of these categories and
19 how many subscribers they would have. Once we derived those
20 estimates, it was a relatively simple matter to find the
21 royalty fee.

22 Of course, we were making some assumption. We
23 assumed all 1,500 systems paid \$30 per year. Fifteen on a six-
24 month payment period. But \$30 per year to arrive at this
25 royalty fee as you will see in your footnote.

etpl5 1 The next category 80,000 to 160,000, we calculated
2 the royalty fee based on one-half of one percent of the total
3 gross revenues. Then in the third category, since the law
4 provides for a sliding scale, we assumed a payment of two-thirds
5 of one percent in this category.

6 Once we were able to derive each of these estimates,
7 we added them up. As I indicated on the prior chart, we sub-
8 tracted these totals from the totals mentioned in the legislative
9 history to give us an estimate of the DSE systems' payments and
10 the royalty fee per subscriber so we could have some kind of
11 breakdown and we could make direct comparisons.

12 Q This shows us how we got the 1976 estimate as to
13 what it was based on what Congress said it would be for all
14 systems. It shows how we got it for the large systems.

15 What is the most recent period for which we can
16 calculate the royalty fee per subscriber as of this date.

17 A The most recent information that I could find was
18 the statement of account forms filed at the Copyright Office along
19 with the copyright payments for the period 1979-2, the last
20 six months of 1979. The last complete information available.

21 Q Does that statement of account form ask for infor-
22 mation as of what date?

23 A The end of 1979, December 31, 1979. That takes us
24 up to the beginning of this year.

25 Q Would you explain to us what you have done and what

1 you have arrived at?

etpl6 2 A In our analysis of the statement of account forms
3 that were available in the public information file in early
4 September, we analyzed 3,756 forms. We found that these forms
5 contained a reported subscriber number of almost \$14 million,
6 they paid \$7.5 million in total royalty payments on a semiannual
7 basis.

8 That computes out to a royalty fee per subscriber or
9 54 cents annually is \$1.08, for the most recent period available.

10 COMMISSIONER JAMES: Did you do this in-house or
11 did you send it out to be done?

12 THE WITNESS: In-house.

13 BY MR. FELDSTEIN:

14 Q In doing this since you looked at all of these
15 statements of account forms, Mrs. Beales, I note that there is
16 \$7.4 million of total royalty payments appearing here. How
17 much in total was paid during that period?

18 A Well, apparently, if the number of is not final.
19 That is at this point. The last update I received from the
20 Copyright Office which I received \$8.1 million.

21 Q That is \$8.1 million collected for '79?

22 A That is correct.

23 Q There is a difference between 74 and 81. What do you
24 attribute this to?

25 A Several factors. We utilized the statement of

etpl7 1 account forms in the public information file. At the time I
2 analyzed the file, I found 3,858 forms in the file. There is
3 a difference. I am sure the Copyright Office. I don't work
4 at the Copyright Office. I would assume some of these are in
5 processing or because these are copies that appear in the public
6 information file, perhaps, some have been misplaced.

7 We analyzed a total of 3,858 forms. We rejected
8 102 forms from our sample to finally arrive at the figure of
9 3,756. We rejected these because in several cases there were
10 obvious duplicates in the copying process, or again, in the
11 process of copying, the page with the number of subscribers would
12 be missing or illegible or something like that.

13 Finally, there were some systems that did not report
14 their subscribers in an accurate way although that was a small
15 part of the total. We arrived at the final total of 3,756
16 forms.

17 Q The answer is at this point \$1.08 royalty fee per sub-
18 scriber as of December 31, 1979?

19 A That is correct on an industrywide basis.

20 Q Were you able to break this down so we can see a
21 DSE paying system figure?

22 A Yes. It was relatively easy to do because we worked
23 with statement of account forms which are filed Form 1, 2 or 3.
24 In the next chart which is 4A, we have the current cable
25 industry royalty fee paid persubscriber reported by gross receipts

1 categories utilizing 1979 information. As you can see for DSE
2 systems a gross receipt of more than \$3,020. We analyzed
3 1,015 forms. The reported subscribers were over 10 million.
4 Royalty \$6.9 million which divided to royalty fee per subscriber of
5 64 cents or analyzed \$1.28.

6 Q Thus, it is \$1.08 for all systems and \$1.28 for
7 the DSE paying system?

8 A That is correct. The calculation for smaller systems
9 is also included. Forty-eight cents for medium size and six
10 cents for systems paying on a flat rate basis.

11 Q The next chart is Exhibit 5 in the soft pack. Can
12 you explain this chart to us?

13 A Well, we gathered the information for 1976, from the
14 legislative history which told us the royalty fee per subscriber
15 estimated at the time of enactment was 81 cents. We have now seen
16 from the royalty fee per subscriber is \$1.08, which is an increase
17 of 33 percent.

18 I have also included on this chart for your compari-
19 son, the information provided by Mr. Crandall in terms of the PCE
20 deflator which has gone up almost 31 percent for that same period
21 of time.

22 Q If we were to use it, if the Tribunal were to use the
23 royalty fee per subscriber for only the SE systems, which
24 we have seen calculated for both 1976, and the end of 1979,
25 what are those comparative numbers and percentages?

1 A Back '76, based on our estimate, we came up with
etp19 2 91 cents for the most recent period we reported up to the
3 end of '79, we had \$1.28 for an increase of 31 percent. Very
4 similar to the increase for all systems.

5 Q For all systems in '76, it was 98 cents?

6 A Yes. And increased to \$1.28, which is an increase
7 of 31 percent.

8 Q Did you make any effort to check although no
9 relevance to the determination that the Tribunal must make,
10 along a midpoint to see what the copyright royalty payment per
11 subscriber was at an earlier time?

12 A Actually, this was a byproduct of another study
13 we conducted. But it gave us a checkpoint as to what happened
14 in the first reporting period when cable systems started paying
15 copyright fees in 1978.

16 We have the estimate for 81 cents which increased
17 to \$1.08. The information we have for the first period was royal-
18 ty fee per subscriber was about 98 cents. This was a sample
19 of 100 random forms filed at the Copyright Office and gives us
20 a checkpoint of the information.

21 One important point to note in the clear trend line
22 is this information although the law was enacted back in October
23 of 1976, the information was earlier. According to the estimate
24 printed in the fact book, the first of the year in 1976. So,
25 we have 30 months in between this period, the information for .

etp20 1 1976, as in all of the reporting periods of the statement of
2 account forms is the last day of the reporting period. For
3 this portion of the trend line, we have 30 months.

4 We have an increase of about 20 percent. For the
5 remaining months, we have an increase of about 10 percent. We
6 have a pretty good trend line here.

7 Q Now, we have seen that the royalty fee per subscriber
8 has increased. We have been able to demonstrate that. In
9 order for the Tribunal to understand what could have contributed
10 to this actual increase in the royalty fee per subscriber have
11 been able to come up with any explanations?

12 Do you have any explanations for this?

13 A Yes, I do.

14 I have been able to identify four components that
15 would contribute to an increase, may contribute to an increase
16 in the royalty fee per subscriber.

17 Q Can you name those for us?

18 A Certainly.

19 The first one and most obviously is the change in the
20 basic subscriber rate. We have seen some information presented
21 about this. We will develop further information. There are
22 three additional factors that I believe if they were to increase
23 they would contribute to an increase in the royalty fee per sub-
24 scribe. The second factor is a change or increase in the
25 additional receipt revenues that cable systems pay as part of.

etp21 1 their gross receipts. The third factor would be an increase in
2 the DSE equivalent which are reported and paid on by cable
3 systems.

4 The fourth would be an internal growth within cable
5 systems that would move the system out of one payment class and
6 into another. From payment class 2 to 3, where we have already
7 seen the royalty fee per subscriber rate is different for
8 those categories.

9 Q Now the first of the four factors which you named,
10 were the increases in rates four basic conditions for subscriber
11 the basic subscriber rate for retransmission service.

12 A Yes.

13 Q Were you able to measure that for the full period
14 under review?

15 A Yes.

16 Q Can you explain to us on your chart Number 7, the
17 results which you have reached and how you have done this?

18 A Certainly.

19 There is a tabulation of the responses to the
20 Copyright Tribunal's Royalty questionnaire. These responses
21 were tabulated as of July 15. So, I am recording a lower number
22 than some of the evidence you have seen although all of the
23 numbers are remarkably similar.

24 I have utilized a somewhat different methodology
25 that I think will enable you to see another dimension of the

etp22

1 responses to your survey. As you can see on the chart we have
2 a number of systems reporting and the basic subscriber rate as an
3 average back in October 19, 1976. We have a rate of \$6.69, for
4 the DSE systems, \$6.64 for the small systems with gross
5 receipts of \$80,000 to \$320,006.16, for the smaller systems
6 with receipts of less than \$80,000.

7 That is a total of 1,673 forms. By April 1980, we
8 have seen a considerable increase. I have counted all responses
9 to that question. We have a measure of the new systems that
10 came on line sometime during the period. You will recall in
11 some data that we have seen, there was only a comparison between
12 the same systems between '76 and 1980.

13 We have an additional factor of the new system.
14 In April 1, 1980, we analyzed 1,939, forms and saw \$7.63, for
15 DSE, \$7.67, for middle systems and \$7.23.

16 We saw increases of 14 percent for DSE, 14 for
17 middle systems and 17 percent for the smaller systems.

18 CHAIRMAN BURG: Slow down, please.

19 THE WITNESS: Overall an increase of 15 percent.

20 COMMISSIONER GARCIA: In looking at these figures
21 that you just gave me and comparing them to your schedule 3C
22 for October '76, two on the one less than \$80,000, is there
23 a typo? _____

24 THE WITNESS: No. That is actually accurate. We
25 found, as you will see on the chart for the tiny system, \$80,000

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tp23 1 and less \$6.16. The way the Tribunal's forms were separated,
2 it was recorded as intermediate size forms. We have the whole
3 category average of \$6.64. On chart 3C, we had to make a divi-
4 sion between 80 to 160 category because they pay on a different
5 basis. One pays half a percent while the other pays a full
6 percent above 160,000.

7 So, it is the same rate broken down twice in the
8 calculation on 3C.

9 BY MR. FELDSTEIN:

10 Q What are you saying is this figure 80 to 320 at
11 a \$6.64 rate on 3C is simply broken down into two categories.
12 Is that correct?

13 A Yes, 80,000 to 160,000 and 160,000 to 320,000.

14 COMMISSIONER GARCIA: Is that the reason we have
15 more systems? At 3C you stopped and 330, you exceed 320?

16 THE WITNESS: Yes. I included the systems with gross
17 receipts of more than 320,000, on 3C. I used the responses of
18 the Tribunal. The other information was generated from the
19 Television Fact Book I mentioned earlier.

20 BY MR. FELDSTEIN:

21 Q So, you have presented new data as to the rates of
22 new systems April 1, 1980?

23 A Yes.

24 Q Have you also -- my recollection was the data pre-
25 sented by the copyright owners' off the CRT survey was for DSE

etp24

1 systems. only; is that correct?

2 A That was my impression.

3 Q Therefore, you have also collected data for the
4 smaller systems?

5 A That is correct.

6 Q For the first time, we have information on the
7 rate increases for the smaller system?

8 A That is correct.

9 One other point I might make about this chart,
10 Mr. Feldstein, is that this increase of 15 percent that we
11 find with the Copyright Tribunal questionnaire responses is
12 very similar to the responses we found from a survey that we com-
13 missioned at the A. C. Nielsen Company to conduct. They random-
14 ly selected 150 cable systems nationwide to ask the same questions.

15 They came up with a response of just under 16
16 percent. We see a lot of information to see this as the rate.

17 Q You have identified three other components of the
18 increase in the royalty fee per subscriber. We are unable to
19 track any of these back to 1976?

20 A Unfortunately, I was not.

21 Q Is this because data on these are simply not
22 available?

23 A I was unable to find data back in 1976. For example,
24 on the next chart when we are going to be talking additional re-
25 ceipt revenues, the Tribunal did not ask for additional revenues.

etp25

1 So, we don't have a checkpoint.

2 Q Thus, what you are about to tell us about the three
3 additional components therefore are indications; is that correct?

4 A That is correct.

5 Q Not specific quantifications?

6 A Yes.

7 I want to make that point very clear. We are not
8 trying to pin a specific figure increase on the next three
9 components. We are only presenting an indication that these
10 components may have increased thus contributing to the increase
11 of the royalty fee per subscriber that we have documented
12 already.

13 Q We have seen inflation has gone up either 30.6 or
14 39 percent depending on the measure chosen. We have seen that
15 pursuant to your data and pursuant to copyrighter owners' data,
16 basic subscriber rates have gone up approximately 15 percent?

17 A That is correct.

18 Q Therefore, are you saying that the difference since
19 the royalty fee per subscriber went up over 30 percent, must
20 therefore be explained by other factors?

21 A It would appear to me that that would be the case.
22 The 15 percent may not directly translate to 15 percent of 30
23 percent increase that we have already shown but it would certainly
24 that portion of it would be the major contributor, I would
25 imagine. There must be some other factors.

etp26

1 Q Have you done something to see whether any of these
2 other factors you have been able to identify may well have
3 arisen in the time period?

4 A Yes. I have some indications that these other
5 factors have increased.

6 Q Would you please explain the first one?

7 COMMISSIONER JAMES: Before you go on. Let's go
8 back to 1976, and this estimate. Did I just understand you to
9 say there is no way you can actually tell what payments would
10 have been made in 1976?

11 THE WITNESS: I did not attempt to do that because
12 it was provided in the legislative history. It said quite
13 clearly that they estimated --

14 COMMISSIONER JAMES: Is there any way we can actual-
15 ly find out what the payments would have been?

16 THE WITNESS: I don't believe that I could do that.

17 COMMISSIONER JAMES: Go back to chart 3. If the
18 estimate should have been 15 million and you knew you had 10.8
19 subscribers you would have had a different figure?

20 THE WITNESS: Correct.

21 COMMISSIONER JAMES: Is there any documentation
22 to show that Congress was right in their estimation? You
23 keep harping on the \$8.7 million. It is an estimate, an
24 approximation. Is there something in your records because it
25 is your industry that would clearly and unequivocally indicate

etp27

1 what that actual figure was? As I keep going through your
2 things, you keep coming back to 81 cents. It does not deal
3 if we start out with a faulty figure to begin with. Congress
4 is not holier than thou. 8.7 was an estimate. What was
5 the actual figure? If it was 10 million or 15 million, you
6 would have a different figure, wouldn't you?

7 THE WITNESS: I was not involved in the 1975-76
8 process that yielded this estimate. In looking through the work
9 sheets and files at NCTA, I found that estimate was based on
10 currently available information is how it was sourced.

11 I do not. I think perhaps other people could speak
12 better to this. An additional point I think you have to remember
13 is we do have the checkpoint for 1978 one. When cable systems
14 started paying copyright. That goes in a clear trendline and
15 the increases seem to fall in a consistent pattern. We have some
16 indication that it is part of a trend.

17 COMMISSIONER JAMES: I don't want to say play that
18 way but repeat that again for me?

19 THE WITNESS: Chart 6. We have an indication at the
20 midpoint of this period or somewhere in the midpoint that
21 based on my sample of 100 statement of account forms filed with
22 the Copyright Office in that first reporting period, the royalty
23 fee per subscriber was 98 cents.

24 That falls in a consistent trendline with the
25 other information we have available.

1 COMMISSIONER JAMES: Only if you assume that the
2 first thing was right. I can't assume that because you have
3 not given me direct evidence to support outside of what is in
4 the Congressional Record. You say you went back and reviewed a
5 lot of the figures you inherited?

6 THE WITNESS: Yes.

7 COMMISSIONER JAMES: They did not indicate anything
8 more than an approximation?

9 THE WITNESS: In all honesty I can't say I remember
10 all of those worksheets. I have not reviewed them since we
11 started this process in preparing for the hearings. In talking
12 with other parties involved and looking at the worksheet, I
13 see the consistent repetition of \$8.7 million.

14 COMMISSIONER JAMES: That may have been stuck in
15 everybody's mind. In applying the rate to the figure conceiv-
16 able to you, could you not come up with a different rate than
17 8.7? You get 81 by dividing 10.8. If you use another enumerator,
18 you have a higher figure than the 81 cents?

19 THE WITNESS: That is true. I do know in '75-76,
20 I have indications that there was an estimation made of the
21 number of systems that would be paying in each category and
22 the number of systems and the DSE category or an estimation of
23 how many DSEs there would be.

24 That was based on samples that were taken, a
25 fact book data available. Actually looking at all the cable

etp29

1 systems and seeing what their gross receipts were, monthly
2 subscriber charge and how much subscribers they had. They went
3 through numerous calculations and came up with this estimate.

4 Again, I was not a participant. I can only look
5 back at the worksheet and see they had these calculations.
6 I can look back at four or five-year old worksheets.

7 COMMISSIONER JAMES: Can't you take our survey?
8 Does our survey under your qualifications --

9 THE WITNESS: Your survey did not ask about royalty
10 fee paid.

11 MR. FELDSTEIN: Possibly, I can help you by asking
12 a couple of clarifying questions.

13 COMMISSIONER JAMES: Please do.

14 BY MR. FELDSTEIN:

15 Q The data in order to calculate under the Act how
16 much copyright would be paid, was cable paying copyrights in
17 1976?

18 A Not to my knowledge.

19 Q When did Cable first have to file statement of
20 account forms?

21 A In the first period of 1978, first six months.

22 Q Did Congress recognize that Cable was not yet
23 paying copyright when it enacted this Act?

24 A Yes. It specifically mentioned that in the
25 legislative history.

ETP30

1 Q Did Congress recognize that it did not have nor
2 could it have the data available to make an exact calculation?

3 A Yes. That seemed clear from the wording of the
4 legislative history.

5 Q Does the legislative history, therefore, rely on an
6 estimate?

7 A Yes.

8 Q Does the Act talk about a royalty fee per subscriber
9 as of the date of enactment?

10 A Yes.

11 Q Therefore, does not the legislative history say as
12 you stated from the legislative history look back at your
13 chart 3. We can refer to the soft charts.

14 Can you read to us from the third line to the end of
15 the sentence?

16 A Page 91?

17 Q 175. In the Committee's view and based on projec-
18 tions.

19 Q No. The third line from the top of page 175. And
20 accordingly that the royalty per subscriber may be calculated
21 at the time of enactment must necessarily constitute an estimated
22 value.

23 Q In other words Congress was unable to do other than
24 use an estimated value?

25 A That is correct.

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Q Therefore, since Congress was unable to do that in 1976, the CRT and NCTA are unable to reconstruct what Congress in 1980, what Congress could not do in 1976.

A I have not been able to do that.

CHAIRMAN BURG: I think this is an appropriate time to conclude for today. We will adjourn until 10 o'clock tomorrow morning.

THE WITNESS: I would make a correction on my remarks. The one time adjustment in our proposal was several million dollars. In revised exhibit the difference is \$16.8 million.

CHAIRMAN BURG: We are adjourned.

(Whereupon, at 4:20 p.m., the proceedings were adjourned, to reconvene at 10 a.m., Wednesday, October 1, 1980.)